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China's foreign direct investment in Russia under the "belt and road" initiative

Abstract：Since China put forward the "Belt and Road" initiative in 2013, with the rapid development of China's foreign direct investment, China's FDI in Russia has also increased rapidly, which is embodied in two aspects of scale and structure of China's FDI in Russia. But meanwhile, China's FDI in Russia also faces four problems: The Russian legal system is not sound enough, and the investment policy lacks long-term stability; China's FDI in Russia is small in terms of scale, and is mainly concentrated in resource-intensive industries; The mode of Chinese Firms' FDI in Russian is single; and China's FDI in Russia has occasional environmental problems. To further expand China's FDI in Russia, the following four policy recommendations are put forward: Strive to eliminate Russia's doubts about the expansion of China's investment cooperation with Russia; Strengthen Sino-Russian investment cooperation in the high-tech industry; Improve FDI mode of Chinese enterprises in Russia; Handle properly the relationship between China's FDI in Russia and its environmental protection.
Keywords：China；Russia；Belt and Road Initiative；FDI；Flow；Stock

Introduction

In 2013, China proposed a major initiative to jointly build the "Silk Road Economic Belt" and the "21st Century Maritime Silk Road"（"Belt and Road", or "B&R"）, which attracted the attention of the international community, including Russia, and the positive response of the countries concerned. Correspondingly, China's foreign direct investment (FDI) in Russia has been developing rapidly. But at the same time, China's FDI in Russia is also facing some problems. Therefore, both China and Russia should actively coordinate and take corresponding measures to further expand China's FDI in Russia so as to achieve mutual benefit and win-win development.

In the study of China's FDI in Russia, the existing literature mainly concentrates on two aspects: one is to study the special issues on China's FDI in Russia. Gao Xin (2012) examined the industrial choice of Chinese enterprises' FDI in Russia from the perspective of industry, and put forward the corresponding benchmark of industrial choice [1]; Li Chuanxun (2013) analyzed the problems and reasons for Chinese investment in the Russian Far East [2]. The two is the research on the new characteristics of China's investment in Russia under the "Belt and Road" initiative. Li Jing (2015) studied the promotion strategy of China's investment in Russia under the background of the "Belt and Road" [3]; Yin Min (2018) analyzed the legal risks and countermeasures for China's investment in Russia from the perspective of law [4].

Based on the data of FDI, from the World Investment Report over the years by UNCTAD, and the Statistical Bulletin of China's Outward Foreign Direct Investment over the years by China's Ministry of Commerce, National Bureau of Statistics and the State Administration of Foreign Exchange, this paper examines the current situation of China's FDI in Russia during the period of 2003-2016, analyzes the characteristics and problems of China's FDI in Russia under the "Belt and Road" initiative, and then explores the countermeasures that both China and Russia should take to further expand China's FDI in Russia.

I. China's OFDI under the "Belt and Road" Initiative

1. The position of China's OFDI in global FDI

Since China carried out the "going global" strategy in 2000, China's outward foreign direct investment (OFDI) has been growing very rapidly. In 2016, China's OFDI flows had reached $196.15 billion, and become the second largest OFDI country over the world. In the same year, China attracted US$134 billion of FDI (foreign capital actually utilized), ranking the top three in the world for five consecutive years. In that year, China's OFDI flows ranked second in the world by country (region), accounting for 13.5% of the global FDI flows of $1.45 trillion.

By the end of 2016, China's 24,400 domestic investors had set up 37,200 FDI enterprises in 190 countries (regions), with a total assets of $5 trillion at the end of the year. In 2016, China's OFDI stocks was $1357.4 billion, ranking sixth in the world, accounting for 5.2% of the world's total FDI stocks of $26.16 trillion (see table 1) [5].

Table 1. Ten Largest OFDI Countries (Regions) in 2016

Countries (Regions)	**Flows （US$ Billion）**	**As Percentage of Global Flows（%）**	**Countries (Regions)**	**Stocks （US$ Billion）**	**As Percentage of Global Stocks （%）**
US	299.0	20.6	US	6383.8	24.4
China	196.15	13.5	Hongkong, China	1527.9	5.8
Netherlands	173.66	12	UK	1443.9	5.5
Japan	145.24	10	Japan	1400.7	5.4
Canada	66.4	4.6	Germany	1365.4	5.2
Hongkong, China	62.46	4.3	China	1357.4	5.2
France	57.33	4	France	1259.4	4.8
Ireland	44.55	3.1	Netherlands	1256.0	4.8
Spain	41.79	2.9	Canada	1220.0	4.7
Germany	34.56	2.4	Switzerland	1130.9	4.3
World	**1.45 （US$ Trillion）**		**World**	**26.16 （US$ Trillion）**	70.1%

Sources：UNCTAD, *2017 World Investment Report*.

2. China's scale of FDI in the Belt and Road countries

There are 64 countries and regions along the Belt and Road, including 10 ASEAN countries, 16 West Asia countries, 7 South Asia countries, 5 Central Asia countries, 7 CIS nations, 16 Central and Eastern Europe countries, and Mongolia, East Timor and China. The B&R countries have increasingly become the important destinations for China’s OFDI.

In terms of flows, in 2016, China's FDI flows to 63 countries along the B&R amounted to $15.34 billion, accounting for 11.1% of China's total FDI flows in 2014, and 7.8% in 2016, which was higher than the growth rate of investment in other regions during the same period, especially evident after the financial crisis in 2008. It can be seen that the B&R countries are increasingly becoming the main destinations of China's OFDI, and their importance is increasingly rising. From the stock perspective, at the end of 2016, China's FDI stocks in 63 B&R countries was $129.41 billion, accounting for 9.5% of China's total FDI stocks (see Table 2) [6].

Table 2. Stocks of China's FDI in the Belt and Road Countries (2007-2016)

Year	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Belt and Road Countries （US$ Billion）	9.73	14.98	20.26	29.25	41.68	56.76	72.02	92.46	115.68	129.41
World （US$ Billion）	117.91	183.97	245.75	317.21	424.78	531.94	660.48	882.64	1097.86	1357.39
As Percentage of the World Stocks （%）	8.3	8.1	8.2	9.2	9.8	10.7	10.9	10.5	10.5%	9.5%

3. The country distribution of China's FDI in the Belt and Road countries

From the view of the country distribution, the top 10 destinations of China’s FDI stocks in the B&R countries were: Singapore, Russia, Indonesia, Laos, Kazakhstan, Vietnam, the United Arab Emirates, Pakistan, Myanmar and Thailand. From 2008 onwards, Singapore became the country with the largest flows and stocks of China’s FDI in the B&R countries. In 2016, China's

FDI flows and stocks in Singapore amounted to $3.172 billion and $33.4446 billion, respectively, far exceeding the size of China's FDI in other countries (see Table 3). This not only matters with Singapore's industrial and financial center, developed entrepot trade, political stability, and transparent investment environment, but also closely related to similar Chinese culture. Meanwhile, Russia is the fourth major destination of China's FDI flows to the B&R countries (see Table 3), and the second major destination of China's FDI stocks to the B&R countries (see Table 4).

Table 3. Ten Major Destination Countries of China's FDI Flows in the Belt and Road Countries in 2016 (US$ Billion)

Country	Flows	Country	Flows
Singapore	3.172	Thailand	1.122
Malaysia	1.830	Pakistan	0.633
Indonesia	1.461	Cambodia	0.626
Russia	1.293	Kazakhstan	0.488
Vietnam	1.279	Iran	0.390

Table 4. Ten Major Destination Countries of China's FDI Stocks in the Belt and Road Countries in 2016 (US$ Billion)

Country	Stocks	Country	Stocks
Singapore	33.446	Vietnam	4.984
Russia	12.980	The United Arab Emirates	4.888
Indonesia	9.546	Pakistan	4.759
Laos	5.500	Myanmar	4.620
Kazakhstan	5.432	Thailand	4.533

II. Present Situation of China's FDI in Russia under the "Belt and Road" Initiative

1. The scale of China's FDI in Russia

Generally, China's FDI in Russia has shown an upward trend. China's FDI flows has expanded nearly 42 times within 14 years from $31 million in 2003 to $1.293 billion in 2016. China's FDI flows into Russia have grown rapidly since 2011, which is related to the fact that the economies of both countries are gradually getting rid of the financial crisis and the relationship between the two countries is getting closer. In 2015, China's FDI flows to Russia reached the highest $2.961 billion. In 2016, China's FDI flows to Russia accounted for 0.7% of China's total FDI flows, and ranked 15th among countries that China invested in the same year (see Table 5). From the perspective of stocks, China's FDI stocks in Russia increased from $62 million in 2003 to $12.98 billion in 2016, and it reached the highest level in 2015 with $14.20 billion. In 2016, China's FDI stocks in Russia was $12.98 billion, accounting for 1.0% of China's total FDI stocks and ranking 9th among the 190 host countries and regions that China invested (see Table 6). At present, there are 293 Chinese enterprises registered with the Chinese Embassy in Russia [7].

Table 5. Flows of China's FDI in Russia (2003-2016) (US$ 100 million)

Year	Russia	World	As Percentage of World	Year	Russia	World	As Percentage of World
2003	0.31	28.55	1.1	2010	5.68	688.11	0.8
2004	0.77	54.98	1.4	2011	7.16	746.54	1.0
2005	2.03	122.61	1.7	2012	7.85	878.04	0.9
2006	4.52	176.34	2.6	2013	10.22	1078.44	0.9
2007	4.78	265.06	1.8	2014	6.34	1231.20	0.5
2008	3.95	559.07	0.7	2015	29.61	1456.67	2.0
2009	3.48	565.29	0.6	2016	12.93	1961.49	0.7

Note: The stocks in 2003-2006 is non-financial FDI stocks.

Table 6. Stocks of China's FDI in Russia (2003-2016) (US$ 100 million)

Year	Russia	World	As Percentage of World	Year	Russia	World	As Percentage of World
2003	0.62	332.22	0.2	2010	27.88	3172.11	0.9

2004	1.23	447.77	0.3	2011	37.64	4247.81	0.9
2005	4.66	572.06	0.8	2012	48.88	5319.41	0.9
2006	9.30	750.26	1.2	2013	75.82	6604.78	1.1
2007	14.22	1179.11	1.2	2014	86.95	8826.42	1.0
2008	18.38	1839.71	1.0	2015	140.20	10978.65	1.3
2009	22.20	2457.55	0.9	2016	129.80	13573.90	1.0

Note: The stocks in 2003-2006 is non-financial FDI stocks.

The industry distribution of China’s FDI in Russia

In 2016, China’s FDI flows to Russia was $1.293 billion, accounting for 0.7% of China’s total FDI flows and 12.1% of China’s FDI flows to Europe. In terms of industry distribution, the FDI is mainly concentrated in the mining (41.9%), agriculture, forestry, animal husbandry and fishery (33.5%), manufacturing (17.2%), wholesale and retail trade (4%), leasing and business services (2.9%), financial intermediation (2.8%), scientific research and technical services (1.6%).

At the end of 2016, China’s FDI stocks in Russia was $12.98 billion, accounting for 1% of China’s total FDI stocks and 14.9% of China’s FDI stocks in Europe. China had established more than 1,100 foreign companies in Russia and employed 22,000 foreign employees. Regarding to the industry that the FDI stocks involved in, the mining is $6.18 billion, accounting for 47.6%, agriculture, forestry, animal husbandry and fishery is $3.01 billion, taking 23.2%, manufacturing is $1.16 billion, making up 8.9%, leasing and business services is $1.12 billion, accounting for 8.6%, wholesale and retail trade is $410 million, accounting for 3.1%, real estate is $370 million, taking 2.9%, financial intermediation is $310 million, constituting 2.4% and construction is $240 million, accounting for 1.8%.

Table 7. Major Sectors of China's FDI in Russia in 2016 (US$ 100 million)

Sector	Flows	Percentage (%)	Stocks	Percentage (%)
Mining	5.42	41.9	61.82	47.6
Agriculture, Forestry, Animal Husbandry and Fishery	4.33	33.5	30.07	23.2
Manufacturing	2.23	17.2	11.57	8.9
Leasing and Business Services	0.37	2.9	11.16	8.6
Wholesale and Retail Trades	0.52	4.0	0.41	3.1
Real Estate	0.00	0.0	0.37	2.9
Financial Intermediation	0.36	2.8	0.31	2.4
Construction	-0.03	-0.2	0.24	1.8
Services to Households, Repair and other Services	-0.57	-4.4	0.07	0.5
Scientific Research and Technical Service	0.21	1.6	0.05	0.4
Transport, Storage and Post	0.01	0.1	0.03	0.3
Information Transmission, Software and Information Technology Services	0.00	0.0	0.02	0.1
Other Sectors	0.07	0.6	0.02	0.2
Total	**12.93**	**100.0**	**129.7951**	**100.0**

Sources: China Ministry of Commerce, National Bureau of Statistics and the State Administration of Foreign Exchange, *2016 Statistical Bulletin of China’s Outward Foreign Direct Investment*, p. 37.

III. The Problems Facing China’s FDI in Russia under the “Belt and Road” Initiative

1. The Russian legal system is not sound enough, and the investment policy lacks long-term stability.

Russia's legal system has not been perfect in investment procedures, labor certification, land transfer, and taxation system, resulting in a sharp increase in transaction costs in the investment process which exceed the expected investment returns. What is more, the legal systems between the various federal republics and states of Russia are also different. Chinese companies in Russia do not know enough about business laws, labor laws and fiscal and taxation policies, and they lack experience in tax avoidance, local labor management, and administrative punishment, which leads to high operating costs and low efficiency. There is no effective response to legal disputes, especially labor disputes for Chinese companies and they are relatively passive. It takes plenty of energy for them to deal with such matters. Meanwhile, Russia's investment policy has changed frequently, and the policy has often been unilaterally revised, resulting in Chinese companies in Russia unable to grasp the direction of policy changes and suffer economic losses. Russia’s investment policy has always been heavily influenced by political factors. Political instability is regarded by foreign investors as the biggest source of risk for investment in Russia. The situation in Ukraine, the changes in Russia's relations with Europe and the United States may affect the changes in Russia's economic situation, which in turn will generate large fluctuations in investment benefits.

2. China’s FDI in Russia is small in terms of scale, and is mainly concentrated in resource-intensive industries

Although China's FDI flows and stocks in Russia have grown rapidly, reaching at $1.293 billion and $ 12.980 billion in 2016 respectively, compared with Russia's main source countries and regions, China's FDI in Russia is still limited, which is not commensurate with the scale of the two major economies of China and Russia. In 2016, the top ten source countries and the amount of their FDI stocks in Russia were: Cyprus with $144.021 billion, Netherlands with $46.442 billion, Luxembourg with $44.634 billion, Bahamas with $33.519 billion, Ireland with $29.965 billion, Bermuda with $22.22 billion, Germany with $16.908 billion, the British Virgin Islands with $15.198 billion, Singapore with $14.698 billion and France with $14.466 billion. Obviously, in 2016, China’s FDI stocks in Russia has not yet entered Russia’s top ten sources of FDI, and it was only 9% of Cyprus’, 28% of Netherlands’ and 29% of Luxembourg’s, which shows that there is still huge room for the development of China's FDI in Russia. Meanwhile, China's FDI in Russia has been dominated by resource-intensive, quick-impact and low-tech investments, while the proportion of investment in technology-intensive industries is relatively low. In 2016, in both flows and stocks, the top three industries of China's FDI in Russia are mining, agriculture, forestry, animal husbandry and fishery and manufacturing. Apparently, the industry of China's FDI in Russia is unevenly distributed and the structure is unreasonable, which makes the investment and trade between China and Russia less profitable, hinders the upgrading of China-Russia economic cooperation strategy, and also shows the structure of China’s FDI in Russia needs to be optimized.

3. The mode of Chinese Firms' FDI in Russian is single

FDI can be divided into two forms, greenfield investment and cross-border mergers and acquisitions. Greenfield investment is creating a new business, which means that investors set up branches, affiliates, subsidiaries or joint ventures with the host country. Cross-border merger and acquisition (M&A) refers to cross-border acquisitions and mergers of existing companies in host countries. The experience of China’s FDI is short, which means that it lacks of international experience, and it has a rather single investment mode, which greatly hinders its development. Chinese enterprises mainly focus on greenfield investment, so they often encounter problems such as the lack of international management talents, and the efficiency and profitability of their investment mode are also low. On the contrary, the M&A mode, often adopted by multinational corporations, is rarely applied by Chinese enterprises that carry FDI in Russia. Even if a small number of enterprises adopt M&A, they also encounter problems of small number of shares and lack of management rights and controlling rights. The single mode of China's FDI in Russia has made the return on investment in Russia low, affecting the enthusiasm of Chinese companies for investing in Russia.

4. China’s FDI in Russia has occasional environmental problems

In recent years, Chinese companies’ FDI in Russia has been hampered occasionally because of causing ecological destruction and environmental pollution, and has even been questioned as “predatory development”, “China’s environmental threat” or “China’s ecological dumping”. There are two main reasons for this phenomenon: Firstly, the traditional focus areas of China's FDI in Russia are energy, mineral resources exploitation, agriculture, forestry, animal husbandry, fishery and transportation infrastructure, which are mostly environmentally sensitive or highly environmentally polluting industries. Secondly, most of the Chinese companies involved in these industries invest in areas with abundant natural resources, but the ecological environment systems in these areas are relatively fragile, the Russian environmental protection legal system is not perfect, and the environmental supervision mechanism is not well-developed. In addition, some Chinese companies lack sufficient attention to the issue of ecological environmental protection, which is easy to cause Russia's ecological and environmental problems, which has caused China's investment projects to be severely blocked or even failed.

IV. Policy Suggestions for Further Expansion of China's FDI in Russia

1. Strive to eliminate Russia's doubts about the expansion of China's investment cooperation with Russia

With the increasing of China's investment in Russia and the advancing of Sino-Russian economic and trade cooperation, some Russian officials and scholars remain skeptical about the in-depth cooperation between the two countries. They worry that China's expanding investment will affect Russia's national sovereignty, and result in growing dependence of some Russia's industries on China. What's worse, they hold the view that the strategy docking between China and Russia will enable China to exert influence on Russia's economic lifeline. Since the main contradiction of current Russian economy is the slow industrialization caused by excessive dependence on the energy economy, some scholars fear that the Sino-Russian strategy docking will aggravate its "Dutch disease" and affect its industrialization process. This cognitive bias has led to Russia's ambivalence towards China's FDI: on the one hand, it hopes to expand economic and trade exchanges with China; on the other hand, it does not want to rely too much on China. As a consequence, China's investment cooperation with Russia is hampered by such concerns. Therefore, both China and Russia should make further efforts to promote communications at various levels, eliminate Russia's doubts about China's investment cooperation, enhance strategic mutual trust, strengthen mutual coordination and cooperation, and achieve mutual benefit and win-win results as well.

2. Strengthen Sino-Russian investment cooperation in the high-tech industry

At present, China's investment in Russia is mainly concentrated in energy, mineral resources development, agriculture, forestry, animal husbandry and fishery, and transportation infrastructure, etc. However, less investment is made in high-end manufacturing, especially in high-tech industries. Thus, we believe that China's comparative advantages as a "world factory" and in modern manufacturing have not been made full use of. Currently, both China and Russia are facing the transformation and upgrading of the economic development mode. China's economic development is shifting from high-speed growth to high-quality development, while Russia has to move the economy beyond oil and natural gas. In fact, opportunities are abundant for the two countries to cooperate in the high-tech industry. Although Russia has accumulated rich experience and technology in the fields of aviation industry, chemical pharmacy, weapons development, and high-end equipment manufacturing, its potentials in these high-tech industries are far from being developed due to a lack of funds. By comparison, China has gained considerable experience in many manufacturing sectors, and has a huge market, a large number of skilled personnel as well as ample funds. China is now in an urgent need to upgrade the level of manufacturing and develop more high-end equipment. Therefore, the cooperation between the two countries in high-tech industry is extremely complementary. Hence, China and Russia should reinforce investment cooperation in strategic industries such as aerospace, nanomaterials, nuclear technology, and chemical pharmaceuticals under the framework of the "Belt and Road" initiative and the Eurasian Economic Union. Considering that China has huge market demand for civilian large aircraft, it can jointly develop long-distance large aircraft projects, boost product research and development, and form a new market competition pattern in this field with Russia.

3. Improve the FDI mode of Chinese enterprises in Russia

China should fully play the role of Silk Road Fund, Asian Infrastructure Investment Bank and

Shanghai Cooperation Organization Union Bank in order to provide financial services to companies investing in Russia, solve their financing difficulties, and encourage investment in long-term, high-quality, high-return projects, particularly in key projects such as roads, railways, ports and logistics facilities. The Chinese enterprises are supposed to keep improving the FDI mode in Russia and take various cooperation methods to accelerate the development of investment projects. For example, in the construction of the "Moscow-Kazan High Speed Rail" project, a public-private partnership model (PPP) can be adopted to promote cooperation between the Chinese companies and the Russian government. In some industries with strict control, the Chinese companies can invest through equity participation and taking equity stakes; while in some open industries, they can participate in project construction and operation in the form of holding. The good news is that Russia is considering liberalizing Chinese investment in energy, allowing more than 50% of equity investment, which will make it possible for Chinese companies to invest in the form of holding. Besides, the Chinese firms should be encouraged to make investment in Russia through cross-border acquisitions, since it can increase investment returns, especially for those sectors where the main goal is to obtain strategic assets [3].

4. Handle properly the relationship between China's FDI in Russia and its environmental protection

Industries such as energy, mineral resources exploitation, forestry processing and infrastructure are mostly environmentally sensitive or highly environmentally polluting ones. Therefore, FDI in these fields is likely to cause ecological problems in host countries, which may result in investment projects being hindered or even failure. For one thing, the environmental responsibility of China's companies investing in Russia should be further enhanced. Only by engaging in FDI activities in harmony with the local environment can we finally ensure the maximum and long-term interests of all parties involved in FDI. In other words, it can not only ensure the profit maximization and long-term benefits for Chinese enterprises engaged in FDI, but also contribute to Russia's environmental protection and the fulfillment of overall economic and social development goal. At the same time, the idea and action of Chinese enterprises to integrate FDI with environmental protection is not only a concrete manifestation of their social responsibility, but also an objective requirement for them to establish a good international image, grow bigger and stronger, and even become truly multinational companies with global competitiveness. In addition, this is also what required for China to undertake international obligations as a responsible developing country and implement global sustainable development strategies. For another, the environmental damage behavior of overseas investment companies should be regulated by China's domestic law. It is both rights and obligation for home country to supervise overseas investors without prejudice to the sovereignty of the host country. From the perspective of firms, when conducting any FDI activities in Russia, enterprises should be approved or put on record, comply with both Russian and international laws or regulations concerning environmental protection. At the national level, China should further improve the laws and regulations regarding the environmental protection of enterprises' overseas investment, in order to regulate and ensure the sustainable development of its FDI in Russia.

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