The Impact of Regional Economic Integration on the Cross-Border Investment of Chinese Enterprises

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Abstract: This paper analyzes the impact of regional economic integration on the cross-border investment of Chinese enterprises. On the basis of the overview of regional economic integration, the current situation of China’s regional economic integration and cross-border investment of Chinese enterprises are analyzed. It reveals that regional economic integration has a positive impact on the cross-border investment of Chinese enterprises, especially in promoting the transformation and upgrading of enterprises and improving the international business environment. At the same time, it puts forward the predicament and challenges in international trade competition, including rising trade protectionism and exchange rate risks brought by regional economic integration to the cross-border investment of Chinese enterprises. Based on the aforementioned analysis, this paper proposes the following suggestions. First, government agencies should actively participate in regional economic cooperation organizations to expand their scope of cooperation. Second, Chinese multinational enterprises should comprehensively understand and effectively utilize the preferential policies and rules of the free trade areas to enhance their international competitiveness and formulate sound exchange rate hedging strategies. By proposing measures at both the government and enterprise levels, this paper aims to enable Chinese enterprises to better engage in cross-border investment activities.

Keywords: Regional Economic Integration, Cross-border Investment, Trade competition

1. Introduction

Regional economic integration, an economic development pattern evolved in the world economy. It is mainly manifested that countries in a certain region develop their economy by taking the region as a unified whole in a way of ceding part or all of their economic sovereignty.

Chinese scholars have had substantial in-depth discussion on this issue. Wei XIONG (2023) found that regional economic integration has a positive impact on enterprise innovation[1]. Ren-wen MU and Xu ZHAO (2023) demonstrated that regional economic integration can promote member countries’ economic growth by reducing trade barriers, eliminating cross-border market barriers[2], and promoting the establishment of a unified market Hui-zi LIU (2022) studied the impact of regional economic integration on international trade, arguing that regional economic integration can promote international trade, while at the same time, it may hinder international trade due to the trade barrier restrictions on non-regional countries[3]. Yan-hua GONG(2022)and Yuan GONG (2022) analyzed the economic development between China and ASEAN countries using the Southeast Asian section of the Trans-Asian Railway as an example. The study concluded that regional economic integration would serve as a new driving force for economic growth in the China-ASEAN region.[4][5]

Overseas scholars have also carried out relatively comprehensive analyses on regional economic integration. For instance, Jinji Naoto (2021) investigated the benefits of regional economic integration. The study revealed that the implementation of comprehensive regional trade agreements (RTAs) would bring substantial profits in terms of trade in goods, foreign direct investment, global value chains, as well as research and development (R&D). Nonetheless, sophisticated cooperation mechanisms are still in need for further development of regional cooperation organizations[6]. John Bosco Nnyanzi, Peter Babyenda and John Mayanja Bbale (2016) delved into the impact of regional economic integration on taxation. Using East Africa as a case study for regional integration, the above-mentioned researchers developed a taxation estimation model based on data analysis from 1980 to 2014. The study revealed that regional economic integration can indeed yield positive effects on taxation, contingent upon the
presence of a robust mechanism within the region. The validity of the aforementioned findings is further verified through the application of the generalized method of moments (GMM)[7].

2. Analysis on the Positive Impact of Regional Economic Integration on the Cross-Border Investment of Chinese Enterprises

2.1. Fostering Trade Facilitation

Member countries in the region are entitled to preferential trade policies without excessive trade barriers, making it easier for them to obtain considerable economic benefits. The essence of regional economic integration lies in trade facilitation by eliminating or reducing tariff and non-tariff trade barriers among member countries. Free trade agreements not only enable Chinese enterprises to enter a larger market, where their products enjoy preferential treatment with zero tariffs, but also create greater opportunities for resource allocation so that they can invest overseas smoothly. In the meanwhile, regional economic integration provides enterprises with lower import costs and greater operation freedom. In early 2021, China and Mongolia initiated tariff reduction arrangements within the framework of the Asia-Pacific Trade Agreement. Under this arrangement, Mongolia has implemented tariff reductions on 366 items involving numerous industries such as timber, aquatic products, vegetables, fruits, and mineral products, with an average reduction of 24.2%.

As the largest free trade agreement in the world, the Regional Comprehensive Economic Partnership Agreement (RCEP) covers up to one-third of the global economy. It encompasses the Chinese and ASEAN markets, both of which possess immense growth potential and are regarded as highly promising super-markets. The official signing of the RCEP and its subsequent dividends have significantly propelled rapid trade and investment growth, not only in China but also in the wider region, making remarkable contributions to overall economic development. With the implementation of the RCEP, the region experienced a gradual decline in overall tariff levels, coupled with continuous enhancements in trade and investment facilitation. In the first quarter of 2023, the customs clearance process for import and export goods under the RCEP within the Wuhan Customs District was notably smooth. Foreign trade enterprises in Hubei province benefited a lot from the favorable environment, as the value of goods enjoying preferential treatment reached 523 million yuan, reflecting a year-on-year increase of 74.7%.[8]

Furthermore, as a part of Chinese food culture, huangjiu (commonly referred to as “Chinese rice wine”) has been gaining growing attention and demand in the Japanese market. Currently, there are approximately 15 trading companies engaged in huangjiu import business in Japan. Most huangjiu circulating in the Japanese market originates from Shaoxing, with only a minimal portion produced in Shandong or Shanghai. As a result, Japanese consumers have become accustomed to referring to huangjiu as Shaoxing jiu. Following the implementation of the RCEP in January 2022, the tariff on huangjiu has gradually decreased over the years and is expected to be fully eliminated by 2042. Therefore, industry experts predict that dividends brought by the RCEP will further expand the Japanese consumer market for huangjiu.

2.2. Promoting the Transformation and Upgrading of Enterprises

Regional economic integration facilitates the convergence of multiple regional markets, shifting the focus on a singular market of a country to that of a broader region. The larger the market size, the more attractive it will be for enterprises to broaden their vision overseas by expanding their market through cross-border investment. In the meanwhile, through regional economic cooperation, all member countries may grant certain preferential policies to partners in the region, thereby reducing costs, risks and trade barriers for enterprises in cross-border investment. The greater the number of enterprises investing in overseas markets, the more fierce the market competition will be. Subsequently, the whole industry will be upgraded because the enterprises have to develop independent innovation technology and capability to gain the upper hand in the fierce competition.[9]

The rapid advancement of regional economic integration creates abundant opportunities for Chinese enterprises to conduct cross-border investment. Besides, in the process of economic integration, the industrial division of labour and complementary advantages of different countries and regions become increasingly evident. Therefore, cross-border investment has become an essential approach for industrial transformation and upgrading of the enterprises. For one thing, regional economic integration steps up integration of industrial chains, during which cross-border investment plays an indispensable
role in industrial upgrading. For another, with clearer division of labour, it’s easier for enterprises from different countries and regions to find the niche for their products so as to improve production efficiency and lower production costs.

Enterprises can acquire new technology and accumulate management experience through cross-border investment. In the context of regional economic integration, exchanges and cooperation between enterprises in various countries become increasingly frequent, which brings numerous opportunities for Chinese enterprises to learn and cooperation through cross-border investment. All these cutting-edge technology and advanced experience learned from cross-border investment activities are not only conducive to technology innovation and management improvement of the enterprises, but also helpful to promote their industrial transformation and upgrading, continuously enhancing their competitiveness in the market. What’s more, the global industry may also witness upgrading as these enterprises introducing their own technology and management advantages into the new market through cross-border investment.[10]

2.3. Improving International Business Environment

Regional economic integration plays a pivotal role in optimizing the business environment and expediting trade facilitation. It can provide better support and services to enterprises while simultaneously reduce their operational expenses and transaction costs. For instance, if an enterprise from a member country is granted a copyright, patent, or trademark, they gain the privilege of seeking technical assistance from other countries within the region. Since its proposal in 2013, the Belt and Road Initiative (BRI) has stimulated China’s direct investment boom in India. From 2014 to 2019, there was a rapid increase in the flow of Chinese enterprises’ direct investments into India, witnessing a growth rate of approximately 11%. The development and success of these enterprises in India rely on a legalized and institutionalized market operating under the guidance of a stable regulatory body.

As regional economic integration steadily advances, the business environment for cross-border investment has been improved notably, creating more convenient conditions for and expanding the profitability of the enterprises. First, regional economic integration can reduce costs for enterprises engaging in cross-border investment. Throughout the process of economic integration, the disparities in policies, laws, regulations, and other aspects among countries gradually diminish. Consequently, the environment and conditions for cross-border investment become more comparable, which greatly benefits enterprises as it can reduce both investment costs and mitigates risks, enabling them to attain higher returns on their investments. Second, regional economic integration can raise the market access rate of enterprises. Through regional economic integration, the member countries have relaxed and unified market access conditions, which provides strong support for cross-border investment of the enterprises. As a result, they will develop greater competitiveness and win more market share in the target market. Third, regional economic integration can step up policy support and service quality for enterprises. In order to attract more foreign investment, countries within the region make great endeavors to improve the business environment, providing more favorable investment conditions and policy support for enterprises. At the same time, strong support and better service provided by governments also make it smoother for enterprises to carry out cross-border investment activities, from which they are capable of gaining more profit returns.[11]

In conclusion, regional economic integration has a profound impact on cross-border investment by Chinese enterprises in many aspects, most notably in terms of driving industrial transformation and upgrading, as well as improving the overall business environment. Looking ahead, as globalization and economic integration continue to deepen, Chinese enterprises are expected to have more diversified opportunities for cross-border investment.

3. Predicament and Challenges for Cross-Border Investment by Chinese Enterprises under Regional Economic Integration

3.1. Intensifying International Trade Competition

3.1.1. Intensifying Trade Competition Among Countries

Under the new situation, challenges arising from regional economic integration also exacerbate the international trade competition as the world economy encountering new changes in the development process. On the one hand, regional economic integration has a positive economic and political impact
on the countries in the region, as it can advance and drive the development of these countries. On the other hand, regional economic integration has a negative impact on non-regional countries in international trade activities, because it means erecting higher trade barriers against them, thereby intensifying international trade competition. In addition, given that the backbone force of regional economic integration is composed of developed countries, who have a strong political bias when deliberating on the country’s membership application, competition between the countries may gradually evolve into that of regional economic blocs, making it even worse for international trade.

The purpose of signing regional trade cooperation agreements is pushing forward trade facilitation. Although it has been proved by economic theories that zero tariff barrier is the best for countries to pursue maximum benefits, many countries have erected tariff and non-tariff barriers in international trade for other reasons including protecting domestic markets, raising fiscal revenues or retaliating against other countries. Under such circumstances, countries actively seek opportunities to join regional cooperation organizations to pursue trade facilitation and liberalization. Just like a double-edged sword, regional trade agreements are beneficial for international trade among the member countries, while detrimental for non-regional countries as it sets up high barriers for their enterprises in the international trade market. In other words, it is quite challenging for enterprises of non-regional countries to enter the regional market in that their competitors are bestowed with preferential policies. In particular, if a country is excluded by a regional member, it may trigger the chain effect so that all the regional countries may hold biases against it or its enterprises. Nowadays, the profoundly evolving international landscape involves complex and intertwined changes, it is necessary for Chinese enterprises to expand “friend circle” under the strategy of “going out”.

3.1.2. Intensifying Trade Competition among Enterprises

With the market globalization, a growing number of highly competitive enterprises are flocking to the world, posing enormous pressure and challenges to Chinese multinational enterprises. Specifically speaking, multinational enterprises depend heavily on high-tech industries, as well as knowledge and technology intensive products, which charter the direction for the development of the times. Nonetheless, Chinese multinational enterprises are relatively backward in technological R&D investment, and lacking in technological advantages and innovation awareness. Thus, they are far less competitive than high-tech enterprises in other developed countries in the global market.[12]

Chinese corporations’ R&D spending as a percentage of revenues is lower than that of other international conglomerates. The 2022 EU Industrial R&D Investment Scoreboard released by the European Commission analyses the 2500 companies that invested the largest sums in R&D worldwide in 2021. The top 2500 includes 361 companies based in the EU, accounting for 17.6% of total R&D investment, 822 US companies (40.2%), 678 Chinese companies (17.9%), 233 Japanese companies (10.4%) and 406 from the rest of the world (RoW, 13.9% of R&D). Obviously, Chinese companies are still inadequate in R&D investment and weak in innovation capability, thereby facing numerous predicament and challenges in the fierce international competition.

3.2. Rising Trade Protectionism

In recent years, investment protectionism has been on the rise globally, posing increasingly grave challenges to external business environment. Since 2022, some countries have successively introduced protectionist policies to restrict foreign direct investment (FDI) and enhanced national security review of foreign investment, tightening limits for cross-border investment activities in the global market. According to the World Investment Report 2022 issued by the United Nations Conference on Trade and Development (UNCTAD), developed countries expanded the protection of strategic companies from foreign takeovers, in a continuation of a trend towards tighter regulation of investment. According to preliminary data, the number of greenfield project announcements in the first quarter of 2022 was 21 per cent below the quarterly average in 2021, and cross-border M&A activity was 13 per cent below the 2021 average. On September 15, 2022, President Biden issued an Executive Order 14083 on Ensuring Robust Consideration of Evolving National Security Risks by the Committee on Foreign Investment in the United States (CFIUS), especially underscoring its critical role in strengthening foreign investment review process for key sectors that are fundamental to national security, including semiconductor, artificial intelligence, and quantum computing. In addition, more and more EU countries have also formulated foreign investment review mechanisms. Consequently, Chinese multinational enterprises are subject to more rigorous foreign investment reviews in these regions.[13]
3.3. Exchange Rate Risk

Trade facilitation brought by regional economic integration has encouraged an increasing number of Chinese enterprises to expand their overseas market. What’s more important is that the enterprises engaging in cross-border investment should attach great importance to both operational management and control as well as exchange rate and currency exchange issues. In international investment and financing activities, Chinese enterprises often need to convert RMB to other currencies for daily settlement, which exposes them to potential exchange rate risk. Moreover, multinational enterprises usually deal with huge capital flows, even a slight change in exchange rate can cause substantial changes in their capital. Thus, exchange rate risk management is vital for multinational enterprises in operational activities and international transactions.

Midea Group and Haier Group, as representatives of the first batch of Chinese companies echoing the “going out” strategy, have carved out niches in oversea market across different countries and regions. As evident from the annual reports of these successful multinational corporations, fluctuations in exchange rate undeniably have a critical influence on their operational conditions. Hence, they have been constantly reinforcing their management and control over exchange rate risks. In conclusion, enterprises should proactively manage exchange rate risk in their production process to avoid potential losses to the assets and interests caused by uncertainties.

4. Solutions to High-Quality Development in Cross-Border Investment of Chinese Enterprises in the Context of Regional Economic Integration

4.1. Government-Level Solutions

4.1.1. Proactively Engaging In Regional Economic Integration

The international competitiveness of enterprises is essentially a reflection of a country’s competitiveness. In the process of regional economic integration, the government can make efforts to expand the “friend circle” of economic cooperation as wide as possible. Moreover, joining as many economic organizations as possible could help expand the market for Chinese enterprises and facilitate exchanges on international trade and economics as well as economic policies. Furthermore, joining regional economic cooperation organizations can help push our enterprises to improve their innovation capacity and competitiveness on their own. For instance, China has recently applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). This agreement seeks an environment of higher-level opening-up, which encourages multinational companies to proactively meet the high standards of international trade. The government should join more organizations for regional economic cooperation to improve China’s level of opening-up, and steer multinational companies towards higher-level development.[14]

4.1.2. Carrying Out International Cooperation

It is important for us to recognize that regional cooperation should not be limited to economic aspects alone. Cooperation should also occur in areas such as laws and regulations, policies on foreign investment and international capital flows, economic and monetary policies, and cultural exchanges. For example, the types of goods covered by tariff reductions may vary. Multinational enterprises face different market environments when they enter different countries. Therefore, extensive communication and coordination among governments of different countries is necessary to reduce friction for foreign investment by Chinese multinational enterprises, and to reduce risks on legal, political, financial, and cultural affairs, as well as exchange rate and other risks they confront when doing business abroad. Governments should create an international business environment that is conducive to enterprises’ overseas investment and expansion. Only then can the overseas operations of multinational enterprises run smoothly, attract more enterprises to expand overseas, and enhance their competitiveness in occupying foreign markets without any worries.

4.2. Enterprise-Level Solutions

4.2.1. Making Good Use of Preferential Policies and Trade Facilitation Regulations

From an enterprise’s perspective, it is important and crucial to focus on utilizing the “accumulation rules of origin” in RCEP. This is reflected in the fact that it can help lower the threshold for businesses to enjoy tariff preferences, promote deep cooperation in trade within the region, and gradually improve
the regional industrial and supply chains. Taking the RCEP as an example, the certificate of origin (C.O.), which is known as “paper gold”, is a prerequisite for ensuring that enterprises are eligible for zero tariffs. The C.O. is a document certifying that exported goods are originally produced in the exporting country or region issued by a specific institution. The C.O. cannot benefit exporting enterprises directly. However, by helping foreign customers reduce tariff expenditures, it can effectively help foreign trade enterprises establish a consistent and loyal group of customers and explore emerging markets. Therefore, it is very necessary for enterprises to make good use of the “accumulation rule of origin” in RCEP. Specifically, RCEP member countries recognize other member countries’ materials as local materials, which can increase the proportion of the value of origin and make it easier for member countries to enjoy tariff preference support when exporting products.

The Ministry of Commerce of the People’s Republic of China once cited an example of a Chinese enterprise producing refrigerators and exporting them to ASEAN countries. In the production process, it used compressors and other components produced in South Korea. The price of using these components was more than 60% of the total price of the refrigerator, which means that they could not enjoy preferential tariffs subject to the China-ASEAN Free Trade Agreement (CAFTA). However, in the context of the RCEP, the Chinese enterprise could enjoy preferential tariffs, which certify that enterprises should thoroughly interpret the various details in the agreement and explore more business opportunities from it.

4.2.2. Enhancing International Competitiveness

Chinese enterprises should actively adhere to the international advanced level and improve quality standards and rules so as to improve their management and product quality, shifting products towards the middle and high end. They should also enhance the ability to engage in international cooperation and competition, enhancing brand influence and market competitiveness. At the same time, enterprises should give full play to the advantages of China’s large market to improve competition awareness and better respond to challenges. At present, China’s demographic dividend is gradually turning into the advantage in population size. The needs to be met for the people to live better lives with rich material aspects are increasingly broad. Enterprises should proactively enhance their product innovation capabilities to better meet the needs of consumers, make full use of favorable conditions of strong supporting capabilities in China, and prepare for the transformation of labor-intensive industries. The following are some examples of the light industry, textile and clothing industry, and machinery industry.[15]

In terms of light industry, China’s light industry enterprises have strong strength in general. They should seize the major opportunities of tariff reduction and exemption brought by regional economic integration and focus on expanding exports of light industry products, especially to Indonesia and other populous countries. Besides, they should also utilize the opening up of manufacturing investment in Southeast Asian countries, plan the investment of light industry in Southeast Asia, and promote the integration of upstream and downstream industries to realize industrial upgrading and meet international standards to overcome the behind-the-border barriers to exports. To consolidate and enhance their international competitiveness, China’s light industrial enterprises should strengthen brand awareness, increase scientific and technological investment, and increase product added value. At the same time, considering that the outward relocation of low-end and labor-intensive industries is accelerating, enterprises should also move the industry to the central and western regions, vigorously fostering a new development paradigm with domestic circulation as the mainstay and domestic and international circulations reinforcing each other.

As for textile and clothing industry, Chinese enterprises can capitalize on their high overall competitiveness to build China into the most competitive manufacturing and consumption center of this filed in East Asia and even the world. By means of the tariff concession policies, they should expand investment in the region and import cotton looms and high-end fabrics at lower costs, building a win-win textile supply chain cooperation system. Meanwhile, in the context of garment processing business being handed over to companies overseas, the industry chain of product design and development as well as upstream fabric accessories should be kept in China as much as possible.

As a major country in machinery, China has a large importer and exporter, but not strong enough. Regional economic integration can broaden the market for Chinese enterprises. For example, RCEP can help China better expand markets in ASEAN countries, Australia, and other countries. However, they still face the competition of imported products from Japan and South Korea. Chinese enterprises need to study how to seize the opportunity and vigorously promote China’s machinery and equipment to go global, such as combining with engineering projects, participating in international standardization
activities, and improving brand awareness, etc. Indeed, whether it is to seize opportunities or meet challenges, the fundamental is to accelerate industrial transformation and upgrading, speed up the alignment of equipment quality standards with international standards, and steering the industry towards the middle and high end.

4.2.3. **Foreign Exchange Hedging**

Enterprises should be adept in hedging business. In the context of real and compliant trade, if enterprises that are willing to hedge have demand for foreign exchange receipts and payments in the future, the foreign exchange hedging products they launch can be used to lock in sales revenue to reduce the adverse effects of exchange rate fluctuations. It is essential for the healthy development of enterprises. In addition, it is also vital to implement foreign exchange sale and purchase derivatives in tandem with enterprises’ risk-management ability to avoid corresponding issues, such as excessive or insufficient hedging. Upon using foreign exchange hedging products, emphasis should be placed on exploring whether hedging products can help lock in costs or profits. Regarding enterprises, it is necessary to implement the concept of “financial neutrality” appropriately and minimize the corresponding investment behaviors, such as betting on unilateral fluctuations in foreign exchange rate.

Due to the high professional requirements for implementing exchange rate hedging, enterprises should pay attention to developing personnel in this field, including risk managers, ensuring sufficient talent support. Through analysis of China’s foreign trade enterprises, it is found that there is often a void of professional risk managers and controllers. Therefore, it is necessary to strengthen personnel development and focus on their role in helping enterprises identify various potential trade transaction risks in time, exploring risk prevention and control measures based on analysis, and avoiding such problems, which ensures that enterprises can stand firm in fierce market competition. In addition, enterprises can carry out training sessions about foreign exchange, regularly or irregularly, to strengthen their awareness of foreign exchange risk prevention and implement the knowledge in practice. With such awareness, personnel will actively engage and cooperate in risk prevention and control, bolstering enterprises’ economic benefits in international economic activities.

5. **Conclusions**

Based on the above analysis, this paper concludes the following. First, regional economic integration has both advantages and disadvantages for Chinese cross-border investment, but the advantages outweigh the disadvantages. Regional economic integration, as a globalization trend, promotes trade facilitation among member countries. Agreements on regional economic integration signed by China can bring many spillover effects, enabling Chinese enterprises to improve their innovation capacities to better meet consumer demand. Only when enterprises survive in the fierce global competition can they make lasting profits. Second, in response to the adverse effects of regional economic integration, enterprises are suggested to make good use of preferential policies and facilitation rules in trade agreements to enjoy the benefits brought by trade agreements at lower costs. At the same time, they should enhance their market competitiveness to avoid being eliminated by the fierce global competition. Finally, enterprises should take measures to hedge against exchange rate risks when making cross-border investment.

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