Insights into global trends of capital flows’ peculiarities: emerging leadership of China

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Abstract: The presented paper aims to reveal the latest trends of the international capital movement. The following countries/regions are being considered: China, Eastern Europe, Latin America, North America and Western Europe during the years of 2013-2017. Classic economic theory suggests that better developed countries are capital donors, and less developed countries, respectively, are capital recipients. Analysis of the foreign direct investments (FDI) intensity, outflows complimented by mergers and acquisitions (purchases) indicator allows to conclude that the recent picture does not comply statements of classic economic theory, since China, being comparatively less developed country demonstrates vivid economic leadership in terms of exporting its capital to other countries. This behavior can condition accelerated development of China via acquisitions of additional market to own production.

Keywords: capital flows, economic leadership, China

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Introduction

The introduction is about production factors and output of the economic activity. Classic economic theory says that there are two major factors of production, i.e. labor and capital. This means that productive capacity of any country is determined by availability, and of course use of those factors. Those theoretical foundations lie under further ample and more sophisticated elaborations. Those elaborations are related to the quality of labor (conventionally estimated via education and longevity), productivity, level of labor costs, and a wide variety of characteristics of capital, such as capital intensity (% of total GDP), capital structure, understood as the ratio of movable and immovable (fixed) assets. The movable part of the capital, which includes equipment participates directly in the process of production, while immovable capital, or, to put into

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another way, fixed assets, which include buildings, infrastructure, serve as a precondition of the smooth functioning of the production process. This comprising part of total capital is undoubtedly important, alas, does not contribute directly to the production of goods and services. Therefore, a separate strand of scientific literature is devoted to capital structure with the purpose to find the best composition, which would accelerate the growth of GDP. Before switching to the question of capital movement, let us stop briefly on the question related to the estimation of countries productive output. This passage is important for further elaboration related to the effect of capital movement and consequent economic leadership.

Hence, the main conventional indicator of the wealth of any country is GDP, which is understood as the value of goods and services sold via one year. If we want to measure the average wealth of people, who live in a country, we use an indicator of GDP per capita. It is obvious that both mentioned above indicators have to be used for different purposes. We can have a country with high GDP per capita, alas with low GDP, which makes this country rather weak in the bigger geographical landscape. If to return to average wealth of inhabitants of any country, GDP per capita may not reflect the living level of average class if the distribution of income has specific characteristics, i.e. if the high-income class or low-income class prevails (Tvaronavičienė and Gatautis, 2017). Therefore, another indicator for estimating the level of welfare is used. That is Human Development Index (HDI), which along with GDP per capita, takes into account literacy level and longevity (Prakash, Garg, 2019). Despite this indicator in comparison with GDP per capita indicator is much more progressive, it does not solve an issue of estimation of the wellbeing of inhabitants of a country. The components, which are included in this indicator are limited, integration mode of different aspects is under discussion (Dirzytė et al. 2016; Androniceanu et al. 2018).

Apart from GDP which constitutes a component of this composite indicator does not reflect nor deterioration of our planet, neither costs required for its preservation and restoration (e.g. Arbidane and Mietule, 2018).

This passage to the estimation of productive efforts of a country is introduced with a purpose to provide a proper context to the understanding of economic leadership which is outlined, discussed and presented in this paper.

1. Economic leadership and capital movement

If economists and were asked to formulate what economic leadership is, the majority most likely would associate economic power and economic leadership (Katina et al. 2018; Tvaronavičienė 2018; Goncharenko et al. 2019; Stukalo et al. 2019). Here we wanted to raise a question if economic power is associated with wellbeing. The answer most likely would be that the well-developed countries, which are either big or belong to alliances pose economic power and therefore economic leadership. That is rather unanimously adopted,
a conventional approach, which could be found in economic development textbooks. This economic power and wellbeing would be suggested by all variations of economic indicators provided above irrespective to nuances they reflect.

Those well-developed countries, as a rule, have the highly qualified labour force and have sufficient capital. This capital internationalizes into less developed countries in order to use the advantage of lower labour costs. Here we could draw a generalization that well-developed countries are donors of capital, which flow to less developed countries. As a result, both parties benefit - donors of capital benefit in terms of returns of capital invested, and recipients of capital benefit through spill over of knowledge or, to put in a bit modern way, through spill-over of technology (Monni et al., 2017; Zemlickiene et al., 2017).

In case one wants to maintain the logic presented above, the resulting picture of capital movement should be as follows: the less developed countries are foreign capital recipients, while well-developed countries are donors.

Let us look at the landscape, which is being reflected by capital movement data of the latest 5 years. The methodological approach is: we admit that indicator of foreign direct investment (FDI) intensity, expressed in percentage of GDP, reflects the attractiveness of the capital destination. The higher FDI intensity in a country, the more inflows of foreign capital it received if to compare to another foreign capital recipient country. Another indicator, which we will take into account is FDI outflows. This indicator is in USD million in current prices. We admit that a country (or alliance/block of countries), which is the most powerful capital donor is an economic leader. The leadership is perceived in the sense of wanting to benefit from a return on investment. Anyway investing abroad requires an abundance of capital, which in the most common cases is scarce. We believe that in parallel with the movement of foreign capital (both inflow and outflow), an indicator of mergers and acquisitions has to be taken into account. There are two kinds of indicators reflecting mergers and acquisitions: purchases and sales. We will take into account specifically an indicator of purchases since we want to know which countries purchase companies in other countries. Buyers of companies, similarly as capital donors are seen as economic leaders. If the leaders are emerging countries, or as conventionally perceived, well-developed ones, it will be revealed by examining the most recent statistic data. Source of the data employed is UNCTAD, accessed through database Passport, powered by Euromonitor International.
Figure 1. FDI intensity (% of total GDP) in China, Eastern Europe, Latin America, North America and Western Europe in 2013-2017

(Source: Euromonitor International, 2019)

2. Recent tendencies of economic leadership

In order to answer the question about the most recent tendencies of economic leadership, reflected through capital movement, we will take into consideration the following countries/regions: China, Eastern Europe, Latin America, North America, and Western Europe. The rationale of talking those geographic is as follows. China is assumed as an emerging economic power, despite its comparative low development. We want to test how its capital movement looks if juxtaposed to such economic leaders as North America and Western Europe. In order to have a clearer picture of the global landscape, besides China, two other regions have been taken, i.e. Easter Europe and Latin America. Eastern Europe cannot be comparable with Latin America, of course, alas, it can be comparable with Western Europe. Eastern Europe is perceived as a destination of FDI since it is considerably lagging behind Western Europe according to its economic development level. There are respective economic policies adopted with a purpose to attract FDI into Eastern Europe. Hence, we will see if those policies are efficient by monitoring the final result expressed by FDI intensity. We will compare FDI intensity with such regions as Latin America, and China, of course, which is in the centre of our focus. Let us look at Figure 1 above in which FDI intensities in chosen countries/regions are depicted. The reflected data signals, that Latin America is the top destination of
the foreign capital since FDI intensity is this region fluctuates around 4.5 percent. This result significantly outperforms other considered destinations. Eastern Europe with its clearly articulated economic policy directed to encouraging of foreign capital inflows considerably lags behind Latin America, alas outperforms China, which, according to classic logic presented above, should be not less attractive foreign capital destination as Latin America. Depicted data show the considerable difference between Latin America and China in terms of FDI intensity: Chinas’ FDI intensity is twice lower if to compare to Latin America’s FDI intensity. It might mean that economic policies approach towards the phenomenon of foreign capital inflows is different in the considered countries. Latin America encourages this inflow, while China does not. Let us examine the latest capital outflow patterns in the considered countries/regions (Figure 2).

Figure 2. FDI outflows (USD million in current prices) in China, Eastern Europe, Latin America, North America, and Western Europe in the years 2013-2017

(Source: Euromonitor International from UNCTAD)
The data depicted above and showing the capital outflows reveal that the major donor of capital in recent years is China. This phenomenon seems to be not compatible with classic theories, which assume that capital flows from more developed countries to less developed countries. China’s active channeling of its capital towards other countries already gained attention among scholars and practitioners (Shuyan and Fabuš, 2019). The indicated incompatibility is conditioned, most likely, by China’s state policy rather than market-driven intentions, that’s what conventional economic theory says, since states policy can direct capital flows having a specific purpose (e.g. Fabuš and Csabay, 2018; Nikitina et al., 2018). North America and Western Europe act in this area as donors of capital for the rest of considered countries (except China), alas this action is much less intensive if to compare to China’s one. Here we can formulate an important insight: China’s capital donorship to other countries is not market-driven, but policy-driven. Capital export is very intensive if to compare with conventional capital donorship of well-developed countries (Ohanyan & Androniceanu, 2017). This unnatural behavior, which we named “emerging economic leadership” has to be taken into account by other countries since globalization is related to competitiveness are related, ultimately (Mikhaylov, 2018, Tvaronavičienė, 2018, Zeibote et al., 2019).

In order to verify obtained results and support already formulated insights let us now glance at one more indicator, i.e mergers, and acquisitions. As it was mentioned above, there are two indicators available, which this international phenomenon: purchases and sales. Classical economic theory suggests that economically stronger market actors buy smaller and financially less viable companies. If to predict statistics in this area, not knowing it in advance, it would be suggested that better-developed countries are more active in both merger and acquisition activities, i.e. purchasing and sales. Now let us examine Figure 4, in which purchases of companies in considered countries are presented. Let us recall that we focus on the period of 2013-2017 years.

The above-provided data suggest that instead of North America and Western Europe being the most active purchasers of foreign companies, China is a leader in this area. China outperforms mentioned well-developed countries/regions 4 times, e.g. in the year 2017. Hence, we might assume that this tendency appears to be compatible with China’s behavior in exporting its capital. China’s activity in purchasing of foreign companies we see as policy-driven instead as market driven. We do not provide here a figure reflecting sales of companies, and just inform a reader that origin of companies which are is North America and Western Europe (Vasile & Androniceanu, 2018). Hence, if to be very specific, we can claim that China is engaged in buying companies of well-developed countries, what again witnesses about emerging economic leadership of China.
3. Foreseeing future tendencies of capital basing on forecasted economic development of selected countries out of considered ones

Let us look at forecast of development of considered regions. As forecasting tool we will use analytics of database Passport owned by Euromonitor International. This tool allows to get main macroeconomic indicators, specifically, real GDP growth, unemployment rate, inflation and interest rate forecasted until selected period. We select year 2022. Below there are provided forecasts for China, Germany and USA (Fig.4, Fig.5, Fig. 6). The selection of countries under scrutiny is explained in the following way: China is in focus, therefore economic development pattern of this country is crucial factor determining it’s capacity of exporting of its capital to other countries. Selection of Germany for further analysis is conditioned by assumption that this country would conditionally stand for Western Europe in this case. This assumption is
research limitation, of course. The third country, i.e. USA stands for North America. As it was described above, according classic theory of economic development, Western Union and USA, should be main exporters of foreign capital. Let us juxtapose China’s economic development patterns and Germany’s and USA development patterns with purpose to reveal if current economic leadership of China is persistent.

**Figure 4. Real GDP growth, unemployment rate, inflation and interest rate forecasted until year 2022 in China**

Macro Model

(Source: Euromonitor International, 2019)

Fig. 4 reveals that China’s impressive real GDP growth rate recorded in years 2013-2017, during which we examined its capital export, is diminishing. The overall economic situation is worsening. This insight is supported by forecasted data of another 3 macroeconomic indicators, i.e. unemployment rate and inflation, both will increase; inflation will soar. The economic forecast would seem rather gloom, if not the fact that China’s development slowdown, which is recorded in year 2013, approximately, starts from economic development heights, i.e. after reaching 8.2 percent of real GDP growth. Event after reaching its “bottom” at the end of forecasting period in year 2022, it is still above 2 percent, what is, according classics of economic theory, sufficiently good growth rate of real GDP. Let us examine economic patterns of Germany and USA (Fig. 5 and respectively Fig. 6).
Figure 5. Real GDP growth, unemployment rate, inflation and interest rate forecasted until year 2022 in Germany

(Source: Euromonitor International, 2019)

Figure 6. Real GDP growth, unemployment rate, inflation and interest rate forecasted until year 2022 in USA

(Source: Euromonitor International (2019))
Data depicted in Fig. 5 and Fig. 6 shows that development patterns of Germany and USA until year 2022 are rather similar: after some fluctuation real grow of GDP will near 1.6 percent, unemployment will diminish and interest will grow in both countries. To generalize, China will maintain its economic development growth, despite its slow-down, it will be still slightly higher than in Germany and USA. Judging from provided data it could be stated that China will maintain its potential to export its capital to other countries, and, most likely, will do that in case if economic policy remained unchanged.

3. Conclusions

Overall, everyone would agree that the classic economic theory claims that in contemporary world economic leadership of any country depends on the current level of economic development. Economic development is conditioned by two major production factors, i.e. labor and capital. More development countries usually are donors of capital, and less developed countries are seen as recipients. The analysis of the most recent data of international capital movement suggests that China appear to undertake economic leadership in driving its own capital to other countries. China is the most active purchaser of foreign companies, while well-developed countries are the sellers. China’s behavior is not typical for less developed countries. It can be claimed that China may accelerate its development via obtaining new markets through active export of own capital and foreign companies purchasing. Analysis of forecasted development patterns of China, Germany and USA allows to come to a conclusion that China’s leadership in its capital export may remain unchanged during the nearest 3-5 years.

Research limitations: in the provided research ceteris paribus assumption has been adopted.

References


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