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China in Europe

Hungary's Key Role in a Strategic Partnership[1]

Summary
One of the major trends in the world economy in the past two decades was the ascent of China. The fast-growing Chinese economy is already the second largest in the world with an outlook to take the first place from the United States within ten years. Moreover, China is already the world's largest trading nation. At 3225 billion dollars, its volume of trade surpassed the trade volume of the United States in 2010 (Scott–Sam, 2016). With its economy growing, China is also becoming more ambitious. U. S. – China trade approaching 600 billion dollars in 2015, China's economic ties with the United States are already strong. Within the framework of its new land and maritime silk road initiative, China is now reaching out to Europe. As one of the largest economies and markets, and new global companies like Huawei and Alibaba, China is an important trade and economic partner. On the other hand, it is also a potent competitor for markets and resources. Is the ascendance and expansion of China an opportunity or threat? Does China naturally look for partners for mutual benefits and development or does it seek to control the world? Probably both. We attempt to help the reader answer these questions for themselves by looking at various aspects of Chinese expansion towards Europe including investment, trade, Chinese companies in Europe, and some characteristics of Chinese economy and society that may guide its path of future development.

Journal of Economic Literature (JEL) code: F21, F23, F52, F02
Keywords: China, Hungary, European Union, international investment, international business

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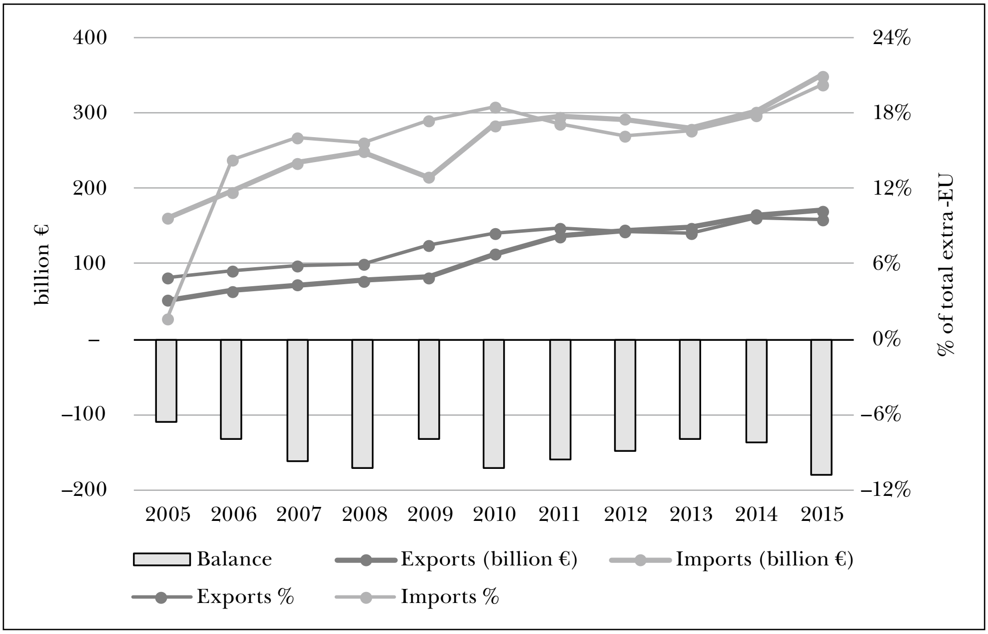
Trade

China is the largest trading nation in the world and an important trade partner of the European Union. In 2015, China was the top partner of EU for imports, and after the United States, the second largest partner for exports. Roughly a fifth of all EU imports came from China and almost a tenth of all EU exports was to China. According to a news release on the EU-China summit last July in Beijing, EU deficit in trade in goods with China reached a record high of 180 billion euros in 2015, while trade in services reached a record surplus of 10.3 billion euros the same yea (Eurostat, 2016a). Trade with China has been growing dynamically in the past decade as shown on Figure 1 and Figure 2.

Figure 1: Development of EU exports and imports of goods with China, 2005–2015

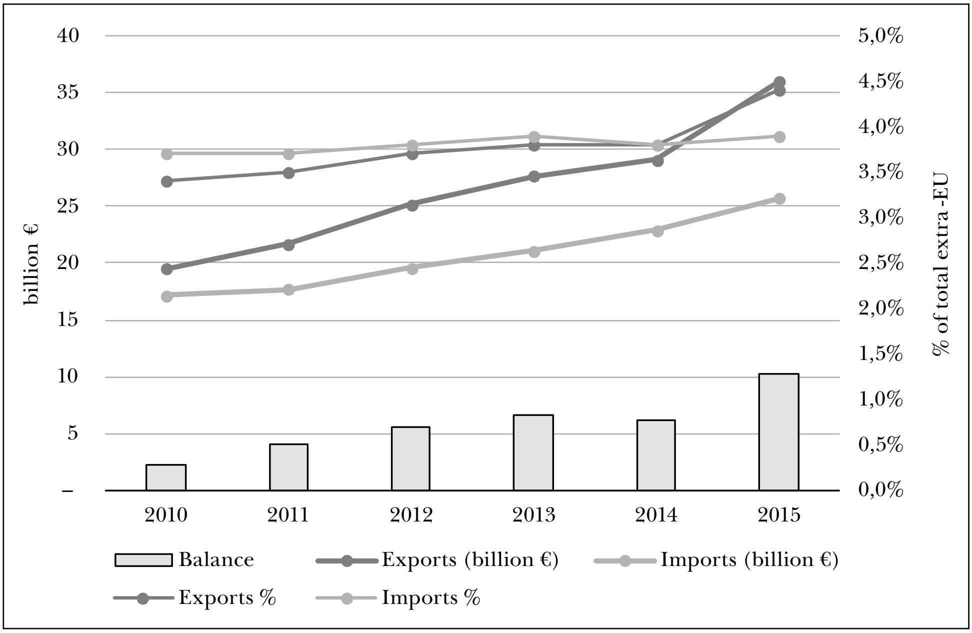


Source: Eurostat, 2016a

Within the EU, Germany is undeniably the largest trade partner of China with exports of goods reaching 71 973 million euros and import of goods reaching 69 036 million euros in 2015. Exports and imports of other EU countries are displayed on Figure 3 below.

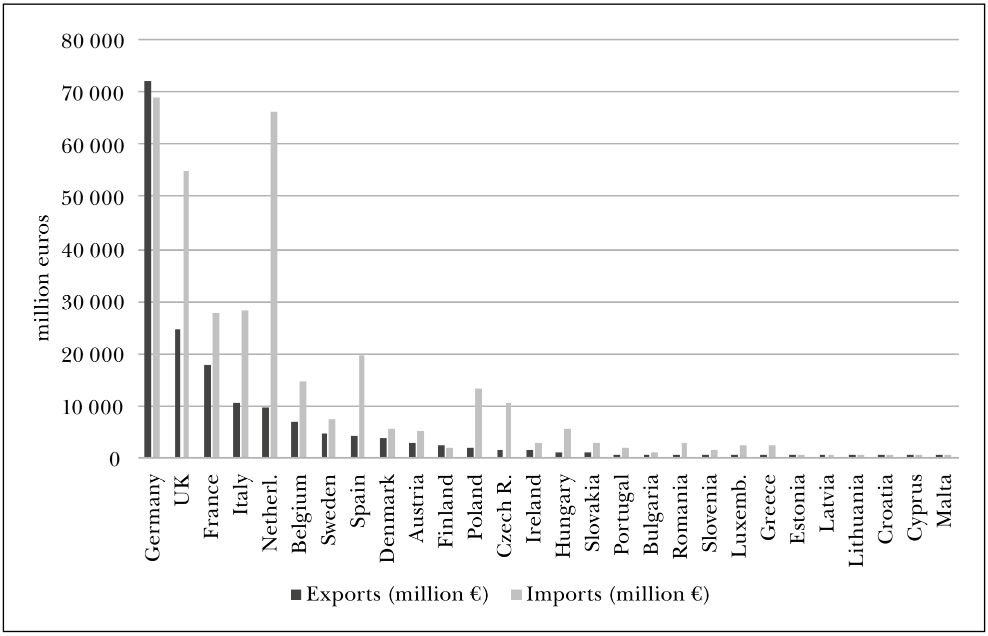
The share of Chine from the total exports and imports of goods of EU Member States is shown on Figure 4. For all EU Member States except Finland China has a larger share of the country's imports than of its exports. However, for some countries, namely Germany, the United Kingdom, France, Sweden, and Denmark, China is also a major export destination. On the other end of the spectrum, China has a large share of the total imports of the Netherlands and Luxemburg but not of their exports.

Figure 2: Development of EU exports and imports of services with China, 2005–2015



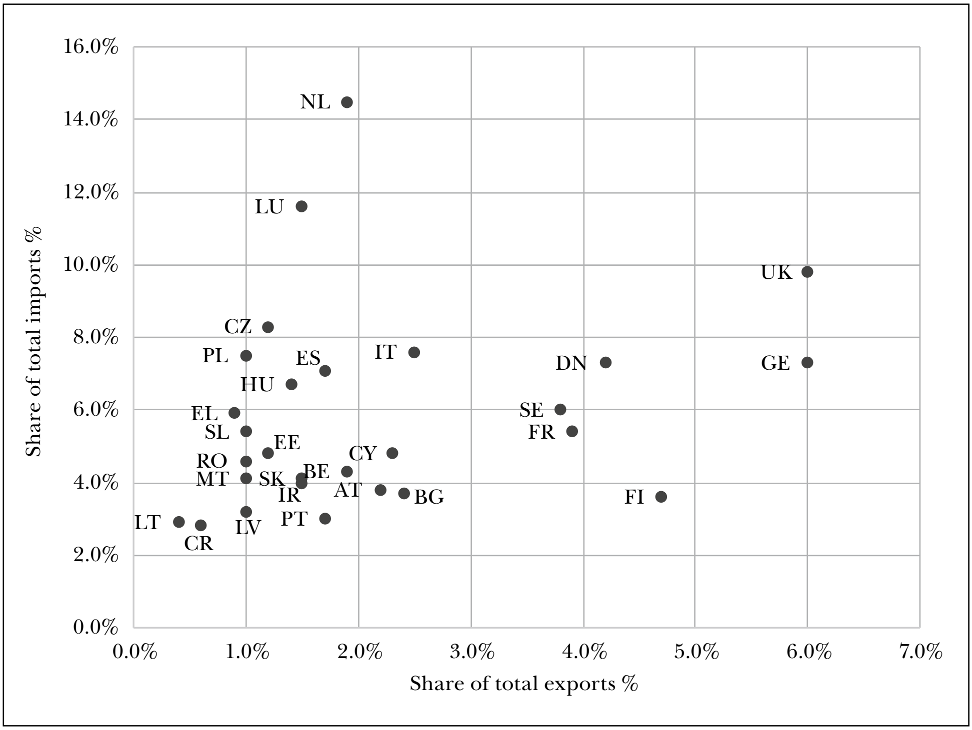
Source: Eurostat, 2016a

Figure 3: Exports and imports of EU Member States in goods with China, 2015



Source: Eurostat, 2016a

Figure 4: Share of Chine from total exports and imports of EU Member States in goods, 2015



Source: Eurostat, 2016a

The Hungarian Central Statistical Office reports different numbers for the imports of goods to Hungary in 2015. According to the Hungarian Central Statistical Office, Hungary imported 7901.8 million euros of goods from China in 2015, 9.65 per cent of a total imports of 81 864.9 million euros. China is the largest source of Hungarian imports outside the EU, followed by Russia (4.35 per cent) and the United States (2.70 per cent). However, Chinese imports still dwarf beside the import from Germany, which is 22.50 per cent of the country's total imports (KSH, 2016).

China is the largest single source of imports for the European Union but may not be the most important source. At 23.9 per cent, the share of European countries that are not EU members exceeds the 20.3 per cent share of China. Other major import partners are the United States with a share of 14.4 per cent, and Russia with a share of 7.9 per cent. European countries outside the EU also take the largest share of EU exports at 22.9 per cent. The second largest share, 20.7 per cent, goes to the United States and China is only the third largest EU export destination with a share of 9.5 per cent (Eurostat, 2016b).

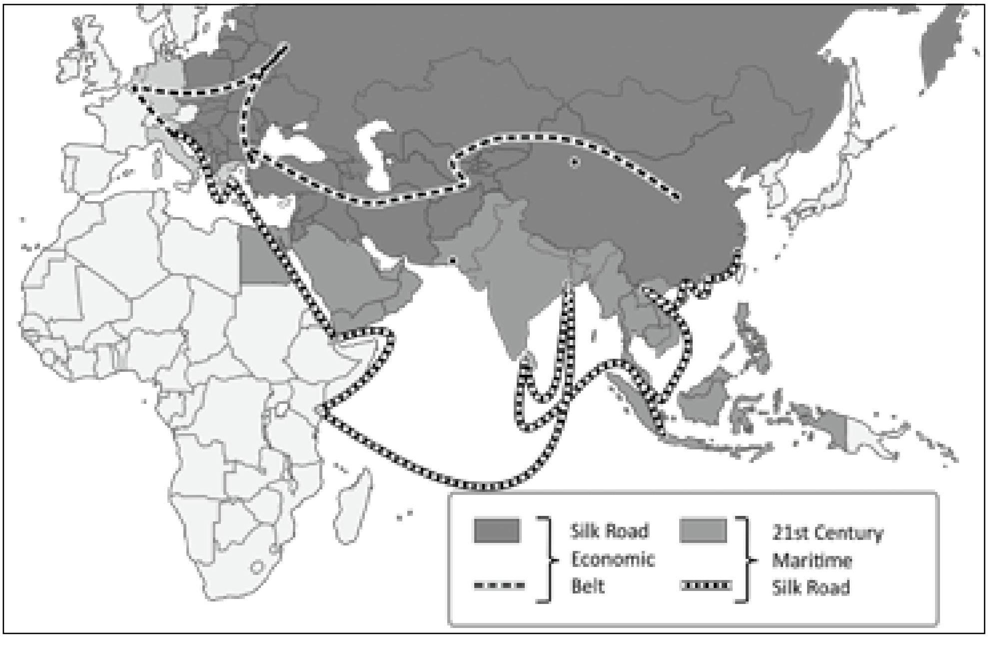
Regarding the composition of Chinese exports and imports in goods, manufactured goods, mainly machinery and vehicles dominate both the exports and the imports (Eurostat, 2016a).

OBOR

With a growing economy and deepening trade relations, China recognized it is time for more. In 2013, President Xi Jingpin of China announced the One Belt One Road initiatives, a strategy for open and advance the country's neighborhood diplomacy. The initiative aim at the joint development of huge economic zones on the Eurasian continent and reaching out to Africa with the leadership of China. One Belt stands for the economic belt along the ancient silk road, a network of trade routes connecting major civilizations across Asia, Europe, and Africa. One Road refers to the 21st century concept of a maritime silk road connecting countries of the Malay Archipelago, and countries along the shores of the South China Sea, and the Indian Ocean (Yi, 2015).

China says its initiative is open to all nations (Yi, 2015) and indeed there is no country list in its official news release about the initiative (NDRC, 2015). A group of 64 countries, including China, however, is frequently mentioned. Figure 5 displays a map of the countries involved and approximate conceptual paths of the Belt and the Road based on analyses of think tanks actively researching the OBOR initiative.

Figure 5: The Silk Road Economic Belt and the 21st Century Maritime Silk Road



Source: Map based on Jinchen, 2016, country shading based on HKTDC, 2017 and Chin et al., 2015

A usual measure to highlight the importance of the OBOR initiative is the share of the OBOR area of the total world land area, population, and the like. According to Fung Business Intelligence Centre, a Hong Kong based think tank, OBOR countries represent 38.9 per cent of the total world land area, 64.2 per cent of total world population, 37.3 per cent of world GDP, and 31.4 per cent of total world household consumption (Chin et al., 2015). Their calculations are based on a list of 58 countries, including China, Greece, Italy, Germany, and the Netherlands but excluding most Central European countries with Hungary, Romania, Slovakia, and the Czech Republic among them (Chin et al., 2015, Appendix I.).

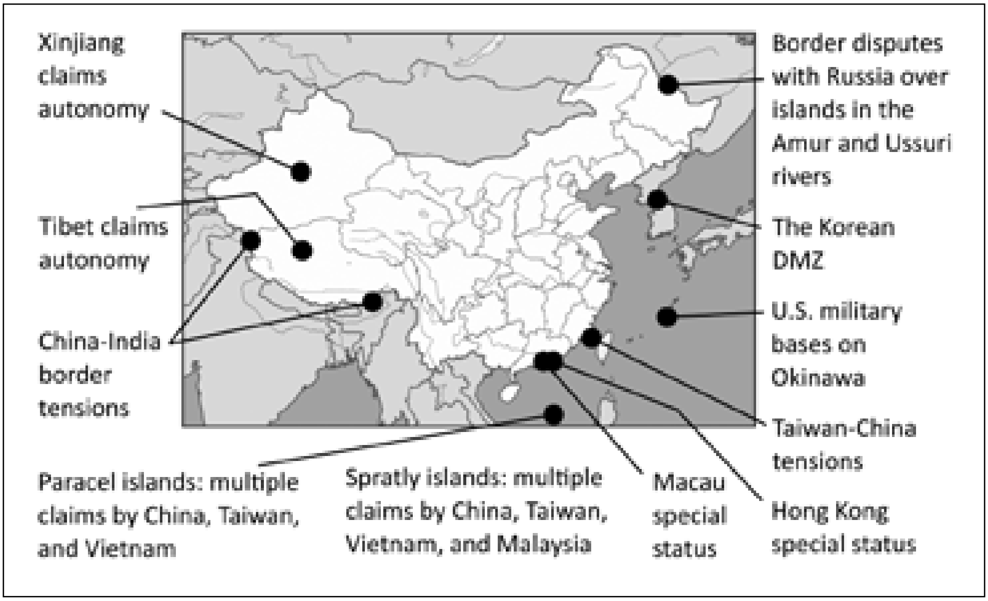
The OBOR initiative is a framework for international economic cooperation. China claims that the initiative upholds the Five Principles of Peaceful Coexistence: mutual respect for each other's sovereignty and territorial integrity, mutual non-aggression, mutual non-interference in each other's internal affairs, equality and mutual benefit, and peaceful coexistence. In other words, China wants to exclude nudging for democratization or discussion of sensitive issues from the negotiations of development programmes.

The OBOR initiative is organized around five priorities. First priority is policy coordination which covers multi-level communication and harmonization of macroeconomic policies as well as political support of large-scale projects along the Belt and Road. Second is facilities connectivity which means better integration of infrastructure of the OBOR countries. The third principle is unimpeded trade or in other words, promoting free trade according to liberal principles. The fourth principle is financial integration. This includes deepening of financial cooperation, building a currency stability system, investment and financing system, and credit information system in Asia. Establishing the Asian Infrastructure Investment Bank also belongs to this principle. Finally, developing a people-to-people bond along the Belt and Road is the fifth priority. This priority includes cooperation in the fields of education, tourism, healthcare, science and technology, employment and entrepreneurship, social security, and public administration, and also the communication between political parties and organizations of the countries along the Belt and Road (NDRC, 2015).

The OBOR initiative has its strengths but there are also challenges from domestic constraints to regional tensions to great power rivalries. China's impressive economic growth has also brought about large regional inequalities with wealth and development concentrated on the South Eastern coastal provinces of the country (Pop, 2016:4). This itself poses a challenge as infrastructure connecting the bulk of China's economy to the Silk Road Economic Belt area has to cross thousands of kilometers through underdeveloped Chinese provinces first. Additionally, the initiative is based on voluntary cooperation between partners but there are tensions in the neighborhood almost everywhere on China's perimeter as illustrated on Figure 6 (Pop, 2016:8). Although these are not necessarily high intensity conflicts, problems may make agreements on project scopes and plans more difficult.

What is in OBOR for Hungary and Hungarian companies? It mainly depends on our own approach to participating in the initiative. "The time has come for elevating cooperation between Central-Europe and China to a higher level, the level of strategic partnership, and this could take place next year" said Prime Minister Viktor Orbán in October 2016 at the conference titled Dialogue Between China and the Central-Eastern-European Political Parties (MTI, 2016d). While a comprehensive strategy to

Figure 6: Tensions and challenges around China's perimeter



Source: Map edited by the author based on Rowntree et al., 2005

utilize the OBOR initiative to Hungary's advantage is yet to be drafted, Tekes, the Finnish government agency for funding innovation, published a short report about the opportunities in participating in OBOR for Finland and Finnish companies (Enright, Scott and Associates, 2016). The report, compiled by Enright, Scott and Associates, a Hong Kong based strategy consultancy firm, says that Finland and Finnish companies have opportunities in OBOR in the fields of development, operation, and maintenance of infrastructure; financial and professional services; transportation and logistics; information and communication systems; commerce, manufacture, and supply chains; and energy, natural resources, and agriculture. In order to benefit from these opportunities, Finland and the Finnish companies should proactively seek and develop projects that can be put under the OBOR rubric, based on their own special strengths and advantages (Enright, Scott and Associates, 2016). Hungary should follow a similar strategy building on its own strengths and active participation.

China reaches out to Europe

The Silk Road Economic Belt stretches through Eurasia but its fundamental goal is obviously to reach Europe. With 18 per cent of China's total export, the United States is the largest export market of the country and also the second largest source of imports at 8.95 per cent of total imports. Exports to Germany, the largest trading partner of China in Europe, were only 3.03 per cent of total exports (The World Bank, 2016.) On the other hand, the 28 countries of the European Union combined constitute the largest economy in the world and the largest consumer market (Bryan, 2015). Accordingly, the European Union combined has already been China's biggest trading partner for more than a decade (Hansakul–Levinger, 2014).

Investment relations are also developing. The European Union is among China's top FDI sources European investments accounting for around 18 per cent of China's FDI stock in 2012. However, this is only 2 per cent of the total FDI stock hold by the European Union. Although Chinese investment in Europe started to rise sharply in 2010, China's FDI in the EU is still tiny and Chinese investment has often been labelled as strategic in the sense that it allows Chinese companies access to European technology in return for financing (Hansakul–Levinger, 2014).

The dynamics of the development of economic relations is also impressive. According to a 2015 report of BusinessEurope, a Brussels based advocate of European enterprises, changes in trade and investment between 2009 and 2013 were as follows (BusinessEurope, 2015:3):

– EU exports in goods to China grew by 80 per cent to 148.3 billion euros in 2013;
– EU imports in goods from China grew by 30 per cent to 280.1 billion euros in 2013;
– EU exports in services to China grew by 71 per cent to 32.2 billion euros in 2013;
– EU imports in services from China grew by 47 per cent to 20.6 billion euros in 2013;
– EU outward direct investment to China grew 1 per cent to 8.2 billion euros in 2013;
– China inward investment to EU grew 1100 per cent to 1.1 billion euros in 2013.

Development of economic relations between Europe and China is a good thing but Europe needs to think about a strategy to enjoy all the benefits without the drawbacks and risks involved. Why should we study China's expansion towards Europe more closely? Because China's tightly controlled economic and industrial policies strongly affect the economic wellbeing of the European Union while its policies in Africa are transforming parts of a neighboring continent whose development is important to Europe. An even more important reason, however, is that treating China as the emerging power it used to be, rather than the global force it has become, is a dangerous mistake.

The present emerging China strategy of Europe is unconditional engagement based on the anachronistic belief that China, under the influence of European engagement, will liberalize its economy, improve the rule of law and democratize its politics. This approach, however, ignores China's economic and political strength and disregards its determination to resist foreign influence. Thus, the EU allows China to throw many more obstacles in the way of European companies that want to enter the Chinese market than Chinese companies face in the EU. Besides, China systematically exploits the division among EU Member States seeing the EU as an economic giant which is weak, politically divided and militarily noninfluential (Fox–Godement, 2009:1–3).

Member of the European Union are split over two main issues about China: 1) how to manage its impact on the European economy and 2) how to engage China politically. Four distinct groups of European countries can be identified:

– The small group of Assertive Industrialists (Czech Republic, Germany, and Poland) are the only EU members willing to stand up to China vigorously on both political and economic issues. Members of this group do not agree that market forces should shape the nature of the EU-China relationship. They are ready to pressure China with sector-specific demands, to support protective "anti-dumping" measures agains unfairly subsidized Chinese goods, or to threaten other trade sanctions.

– Another small group, the Ideological Free Traders (Denmark, the Netherlands, Sweden, and the United Kingdom) are mostly ready to pressure China on politics and mostly opposed to restricting its trade. Free trade ideology also serves the economic interest of these countries. Their high technology and services oriented economies and labor markets benefit, or perceive to benefit, from Chinese growth rather than being threatened by cheap Chinese imports.

– The largest group, the Accommodating Mercantilists (with Hungary among them), share the assumption that good political relations with China lead to commercial benefit. These countries follow protectionist policies on the one hand but shun confrontation with China on political questions on the other. These countries have often kept the EU from more assertive stance on issues like Tibet or human rights and some of them even act like proxies for China in the EU.

– Member States belonging to the fourth group, the group of European Followers, rely on the EU in their policies towards China, support EU policies, but reluctant to participate actively in the debate, feeding the perception that China is not a key EU priority.

The division among Member States makes China perceive the EU as disunited. Any attempt to strengthen the European position must start with the acknowledgment that no member state is big enough to match China alone (Fox–Godement, 2009:3–7).

At first, China saw the EU as a serious political partner, even a counterbalance to the United States. One result of European division, however, is that China is now approaching the EU as an economic space to be used for its own development rather than a serious political partner. While Europeans rely on a strategy of trying to win over China by unconditional engagement, China uses a strategy based on the following three sets of tactics (Fox–Godement, 2009:33–35):

– Taking advantage of the mismatch between its own centralized authority and the rule-based system of government of the EU. China makes full use of the openness of EU markets while using fuzziness of its own administrative channels to restrict access to its own markets.

– China channels EU pressure on sensitive issues, such as human rights, by accepting formal dialogues about them and then turning them into inconclusive talking shops. China reassures the EU by using soothing language about the virtues of multilateralism but the real goal is to deflect European efforts.

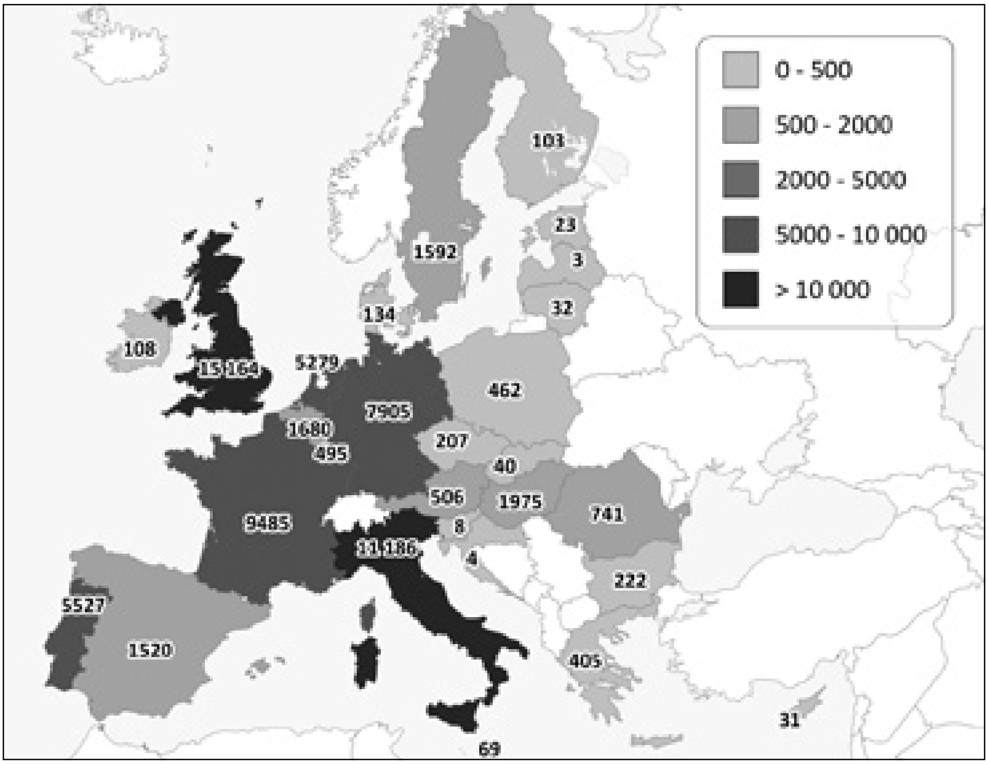
– China exploits and also fosters the division between EU members with unusual ruthlessness, targeting individual Member States with punitive measures when national interests are at stake or short term goals require it. One example: in the building of the high-speed railway between Beijing and Shanghai in the early 1990s, for example, China played German interests against those of France by requesting more and more technology transfers from companies such as Siemens and Alstom (Le Corre, 2015).

No wonder there is a deeply ingrained disappointment within the EU with the direction of Chinese political reform and also a disenchantment in Europe's commercial relationship with China with the two sides having long past their honeymoon (Nicholson, 2015). On the other hand, the attitude of most Chinese towards the European Union or its citizens is positive with trustworthiness emerging as the most characteristic perception (Dekker–Noll, 2012).

EU–China FDI

After three decades of trade integration and significant investment of European businesses in China, the first wave of Chinese capital has arrived in Europe. Annual outbound foreign direct investment by Chinese companies now exceeds 100 billion dollars and has shifted from natural resources in developing countries to technology,

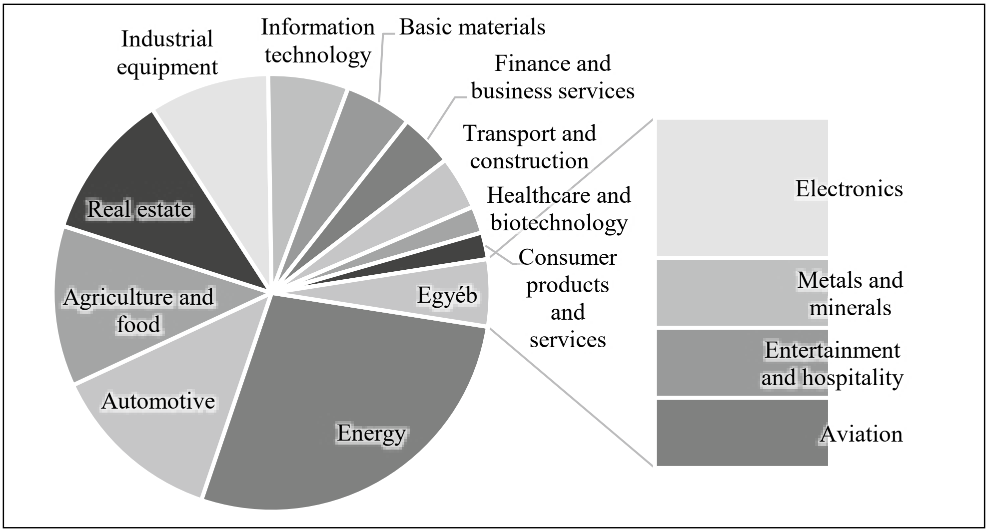
Figure 7: Geographical distribution of Chinese greenfield and acquisition FDI in the European Union with value of cumulative investment from 2000–2015 for each country in million euros



Source: Map edited by the author based on Hanemann–Huotari, 2016, Figure 5 brands, real estate and other assets in advanced economies. Annual investment by Chinese companies in EU Member States also soared from virtually zero in the mid-2000s to 14 billion euros in 2014. From 2000 to 2014 there were over 1000 greenfield projects and acquisitions in the European Union with a total worth of over 46 billion euros (Hanemann–Huotari, 2015:5). Geographical distribution of Chinese FDI is displayed on Figure 7 below. The figure shows data also including 2015 already.

State owned companies play an important role in China's investment in Europe, but growth in recent years is mostly driven by private companies and financial investors from the most advanced eastern coastal provinces. The sectors that attracted the most Chinese capital are energy, automotive, food, and real estate (Hanemann–Huotari, 2015:5). Composition of Chinese investment by sector is shown on Figure 8.

Figure 8: Sector composition of Chinese FDI in the European Union from 2000–2014



Source: Data from Hanemann–Huotari, 2015, Figure 8.2

The growth of Chinese FDI in Europe is a good opportunity to attract much needed capital that can also help in restarting investment and economic growth, and generating spill overs and backward linkages to the Chinese consumer market. However, Europe needs to take some steps to maximize benefits from Chinese investment. First, it needs to implement structural reforms in order to be able to successfully compete with other advanced economies for Chinese FDI. Second, it needs to rethink its approaches to investment promotion and investor support, including an increase of capacities on the ground in China. Third, policymakers need to be prepared to defend the principle of investment openness against populist and local criticisms.

There are also concerns about Chinese FDI because of the unique political and economic system of the country. The EU needs to act on this front as well. The first priority should be a robust bilateral investment agreement between the EU and China that addresses the existing asymmetries in market access through pre-establishment rights for European companies and a short negative list for sectors restricted to foreign investment. Second, Europe should develop a strategy to push China on promised reforms especially in issues of state subsidies and other non-market elements distorting global competition. Third, greater coordination of the security review process in needed to increase the efficiency and coherence of such reviews ensuring there is a functioning solution in place to monitor and mitigate potential security risks (Hanemann–Huotari, 2015:6–7).

From security perspective, China poses new challenges for host countries. In addition to economic risks, FDI can also raise national security concerns for host countries. For example, it can be an additional channel for foreign interests for infiltration, surveillance, and sabotage of critical infrastructures in energy, transport, cyber and financial networks. Another example is the transfer of technology or expertise to a foreign-controlled entity that might be deployed in a harmful way against the interests of a nation.

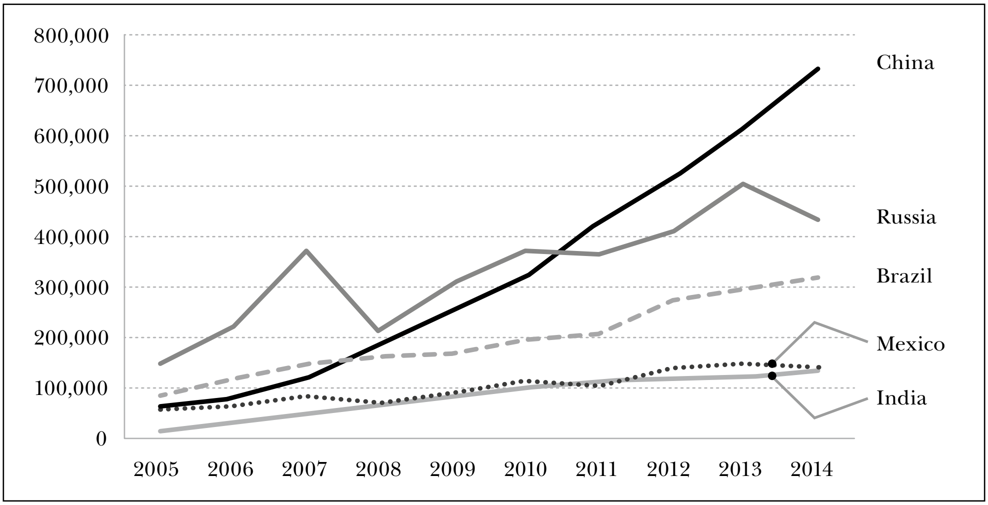
In recent decades, all major source countries of FDI in Europe were democratic market economies with the only significant exceptions of Singapore and Russia. Newly emerging capital exporters, like Japan, were either military allies or simply not large enough to matter. China, however, is different. It is the world's second largest economy, and one of the top five outbound FDI exporters, but it is a country with an authoritarian political regime, a unique economic system, weak security relationship with most major recipient countries and increasing assertiveness on the global stage (Hanemann–Huotari, 2015:41). It also has a completely different concept of war, peace, conflict, and advancing a nations interests (Handel, 1996).

In their 2016 update to their report published in 2015, experts of the Mercator Institute for China Studies and Rhodium Group say the trends of a growing Chinese investment in Europe, together with the related opportunities and concerns, continued. Additionally, slower growth and transition to a new economic model turned Chinese investors even more towards advanced industrial assets, modern services, and real estate, while Chinese investment also increasingly extended beyond the Big Three economies (Germany, France, and the United Kingdom), fueling an intra-European competition for Chinese capital (Hanemann–Huotari, 2016).

In the past decade, China also became the largest outbound FDI investor among emerging economies, surpassing Russia in 2011 as shown on Figure 9. Chinese companies are present in 184 countries and the principal recipient region of Chinese investment is Asia. Europe is only the third, following Latin America and ahead of North America, Africa, and Oceania. Regarding the nature of ownership of Chinese firms with overseas investments, state owned enterprises are still predominant but private companies are rapidly gaining ground (Casaburi, 2016:21).

The largest non-financial Chinese transnational companies in terms of assets held abroad are listed in Table 1. The list is based on data from the Chinese Ministry of Commerce (Casaburi, 2016:21).

Figure 9: FDI accumulated abroad between 2005 and 2014 in emerging economies



Source: Casaburi, 2016, Chart 2

Table 1. Main non-financial Chinese transnational companies in terms of assets held abroad

1	China Petrochemical Corp.
2	China National Petroleum Corp.
3	China Resources
4	China National Offshore Oil Comp.
5	China Unicom Corp.
6	China State Construction Engineering Corp.
7	China Merchants Group
8	Sinochem Corp.
9	China Ocean Shipping
10	China National Cereals, Oils & Foodstuff
11	Aluminium Corp. of China
12	China Mobile Communications Corp.
13	Beijing Enterprises Group Comp.
14	China Minmetals Cor.
15	Guangzhou Yuexiu Holdings
16	Citic Group
17	China Communication Construction Comp.
18	China Power Investment Corp.
19	BOE Technology Group
20	Huawei Technologies

Source: Casaburi, 2016, Table 1

The sectors most targeted by Chinese investment in Europe are energy, real estate, and manufacturing. This pattern differs from China's global investment preferences where business services and leasing, finance, and mining and energy are the most preferred sectors. The main differences between China's investment strategy in Europe and elsewhere are (Casaburi, 2016:47):

– There is very limited Chinese activity in the mining sectors and extraction industries within Europe because of both the smaller deposit of resources and the stringent environmental controls imposed on extraction projects.

– There are more acquisitions of manufacturing companies by Chinese firms in the EU than in other regions the main objectives being the acquirement of technological capabilities and know-how.

– There are more investment projects related to scientific and technical research than in other regions in the world.

The key Chinese investment in Europe between 2010 and 2014 with a value of at least 1 billion dollars are summarized in Table 2.

Table 2. Key Chinese investments in Europe with a value of at least 1 billion dollars 2010–2014

Year	Chinese company	Amount in million USD	Sector	Involved party	Country
2013	China National Petroleum Corp.	4,210	energy	Eni SpA	Italy
2011	Three Gorges	3,510	energy and electricity	Energias de Portugal	Portugal
2011	CIC	3,240	energy and electricity	GDF Suez	France
2014	State Grid Cor. of China	2,811	energy and electricity	Cassa Depositi e Prestiti SpA	Italy
2012	Bright Foods	1,940	agriculture / consumer[2]	Weetabix	United Kingdom
2011	Wanhua Industrial Group Co.	1,552	basic materials	Borsod Chem Zrt.	Hungary
2014	Hony Capital Ltd.	1,540	agriculture	Gondola Group Ltd.	United Kingdom
2012	Sinopec[3]	1,500	energy and electricity	Talisman Energy	United Kingdom
2012	Huawei	1,500	telecom and IT	greenfield	Hungary
2012	Huawei	1,500	telecom and IT	greenfield	Spain
2010	Geely Auto[4]	1,500	manufacturing	Ford	Sweden
2010	China Huaneng Group Corp.	1,232	utilities	InterGen NV	Netherlands
2014	COFCO	1,210	agriculture	Nidera	Netherlands

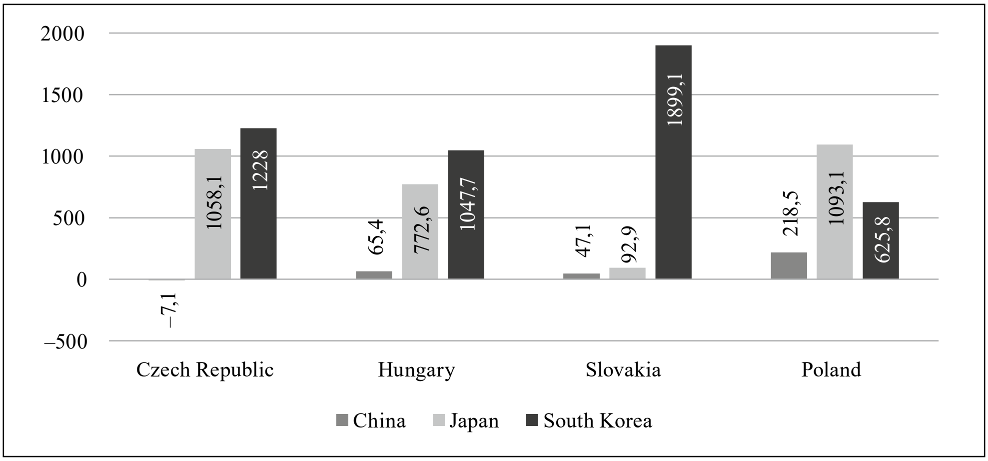
Year	Chinese company	Amount in million USD	Sector	Involved party	Country
2012	Weichai Power Co. Ltd.	1,136	industrials	KION Group AG	Germany
2014	Dongfeng	1,100	manufacturing	Peugeot	France
2011	Petro China Co. Ltd.	1,015	energy	Ineos Ltd.	United Kingdom

Source: Casaburi, 2016:48–55; Hansakul–Levinger, 2014:14

One more transaction from 2008 deserves to be mentioned: Aluminum Corporation of China, teamed with Alcoa Inc., acquired a minority stake in mining giant Rio Tinto of United Kingdom for 14.135 billon dollars (Hansakul–Levinger, 2014:14; Dean–Batson–Matthews, 2008).

As we can see from Table 2, Hungary is also on the map of Chinese investors with Huawei's 1.5 billion dollar greenfield investment in 2012. In their 2015 study, Éltető and Szunomár from the Hungarian Academy of Sciences reviews East Asian investment activities in the Visegrád countries until 2012. Comparing Chinese investment with Japanese and South Korean FDI in the Visegrád countries, she found that Chinese investment was still lagging behind investment from Japan and South Korea in the region as shown on Figure 10.

Figure 10: FDI stock in the Visegrád countries from China, Japan, and South Korea in 2012



Source: Éltető–Szunomár, 2015

The authors also report that Chinese investment in Hungary exceeded 3 billion dollars by 2014, representing about 2-2.5 per cent of Hungary's total FDI stock. About half of that was from the investment of China's Wanhua in Hungary's Borsod Chem, the largest Chinese investment in the Central Eastern European region. Other major investors in Hungary were Huawei, ZTE Corporation, Lenovo, Sevenstar Electronics Co., BYD Electronics and Comlink. Most of the Chinese transnational companies operate in manufacturing and Hungary is also a significant distribution center in the region. In addition to manufacturing, Chinese companies also invest in the chemical industry, telecommunications, trade, wholesale and retail commerce, banking, hotels and catering, logistics, real estate and consultancy. In terms of numbers, most of the Chinese companies operating in Hungary are small businesses in the service and retail sector (Éltető–Szunomár, 2015:16).

In the spring of 2012, Hungary launched a new foreign economic policy focusing on diversifying foreign economic relations by strengthening and developing Eastern economic relations while maintaining its strong existing relations with Western industrial countries. The strategy also includes investment promotion from Eastern countries with China being one of the most prominent partner among them. Despite the efforts, only minor amounts of new Chinese investment have arrived in the country since the start of the new strategy. One reason can be the difference between the approaches and interest of the two sides. Hungary prefers greenfield investments with cheap Chinese financing while China expressed it interest in public infrastructure investment projects and offered forms of financing not compatible with EU regulations (Éltető–Szunomár, 2015:21–24).

Uncertainties ahead

China's recent investment surge highlighted by the economic slowdown created positive excitement in Europe. Indeed, Chinese capital may contribute to the revival of European economies but there are also uncertainties ahead. Will the trend of raising Chinese investments endure? Does China purely follow its business and economic interests or are there hidden political motives? How will China solve its own problems and how will those solutions affect its investments in Europe?

As Chinese banks and investment funds are state controlled, even commercially motivated investments might be leveraged to pursue political goals in the future, while the EU does not have a central investment review system similar to those of other developed countries such as the United States, Australia, or Japan. Without the review system, the EU lacks an important capability to prevent it from losing its industrial capabilities and preserve its technological leadership (Sonzogni, 2012).

One example is both promising and illuminating about Chinese intentions and strategy. In the hope of countering European sanctions for its invasion of Ukraine, Russia tried to strengthen its alliance with China on energy, defense, and agricultural trade and investment. Moscow's strategy, however, has failed as China continued to diversify its energy sources so that rather than playing Europe by engaging with China, Russia is getting played by China (Eder–Huotari, 2016). Two lessons can be derived from Russia's example. First, China seems to follow its economic interest. Second, China was ready to use Russia's weakness to promote its own interests. In other words, China looks for business opportunities but it is not responsible for our own interests, it is up to us to negotiate for a deal that also benefits us.

Another source of uncertainty is that although Chinese investments in Europe are growing, they are still a small share of the total Chinese outbound FDI, and only a few acquisitions are successful either from a profit and value point of view or from a strategic perspective. The successful takeovers are results of synergies with the Chinese partner contributing to competitiveness in specific markets or industries instead of merely funding the acquired company (Sonzogni, 2012).

Regardless of its international ambitions and strategy in Europe, China also has its own internal problems that may add to the uncertainties. Maybe the two most important from the uncertainty point of view are demographic trends and the large income and regional inequalities accompanying its rapid economic growth. These two problems lead China to an economic and political watershed that the country may not pass without trouble.

With life expectancy growing and fertility rate plunging, many fear that China's population ages faster than the country can accommodate. In 2014, people older than 60 reached a 15 per cent share in China's population, a share expected to double by 2050 with median age rising from 35 to 46 during the same period. With a growing number of older people and a shrinking number of younger people, the country's working age population has started to shrink, from roughly 941 million in 2011 to 916 million in 2014. This shrinking work force may raise wage levels, making China lose competitiveness to countries like India, Indonesia, and Vietnam.

There are also good news, however. Employment rate has increased and productivity is expected to rise as people entering the work force are better educated than those exiting. China has also been improving its pension system although this may also rise labor cost while providing more old age security.[5] Regardless whether the state or the family will be the primary provider of eldercare, the problem of an aging society remains. The offspring of today's aging baby boomers were born under China's one child policy, which means that they will need to care for two parents, and sometimes four grandparents, without the help of siblings (Lou, 2015).

An aging population will not only bring economic uncertainties but also challenges to the government of China. Demography, however, is not the only challenge. At the Royal Society in London in 2011 Chinese premier Wen Jiabao declared, "Tomorrow's China will be a country that fully achieves democracy, the rule of law, fairness, and justice. Without freedom, there is no real democracy. Without guarantee of economic and political rights, there is no real freedom" (Huang, 2013:47). Despite the bold statement, however, the Chinese Communist Party has not adopted any genuine political reforms since 1989. This strategy of relying on economic growth cab work only when the economy is booming and China's economy already started to slow down. Additionally, according to 2003 surveys, 72.3 per cent of the Chinese public believes that democracy is desirable, and 67 per cent believes that it is suitable to China so that what has held China back from democracy is not a lack of demand but a lack of supply (Huang, 2013).

Changes may already be under way. Some argue that with the ascension of Deng Xiaoping, China has started its third, and still ongoing, 20th century revolution and even political reforms has "taken place quietly and out of view" (Lampton, 2014:74). The reason for the need for political change is the fact that it is becoming harder to govern for Beijing under the current framework. China's leadership must now confront a population with more resources, in terms of money, talent, and information, than ever before. In addition, the Chinese society, economy, and bureaucracy have fragmented with powerful new economic interest groups, stronger and larger private businesses, a growing number of educated middle class, and more than half a billion Chinese internet users (Lampton, 2014). While the need for change is obvious now, the direction and pace of change is not, contributing to the uncertainty of China's future economic development, including its investment strategy in Europe.

Maybe the most important factor contributing to this uncertainty is the exhaustion of the main driving force behind China's fast development, the seemingly inexhaustible surplus labor from China's rural hinterland. In the past decades, rapid growth of China's industry could be explained by the two-sector model in which the industry is facing a perfectly elastic labor supply curve until there is surplus labor in the agriculture. Under these circumstances, wages do not rise until the industry absorbs all surplus labor (Gillis et al., 1996). However, wages already do rise in China. Since 2001, hourly manufacturing wages in China have risen by an average of 12 per cent a year. Additionally, Chinese industry have been transforming from cheap manufacturing to technologically more advanced industries also including design (Jiaxing–Yangon, 2015).

A more advanced industry requires more advanced skills, making the absorption of surplus labor from the rural hinterland more difficult. This not only means that China hits the wall of the exhaustion of growth based on surplus labor but also means that the two sector of the Chinese economy is decoupling, leading to an unbridgeable gap between the two. As industrial development in China is concentrated on the coastal provinces, this also means that the country itself is divided into a dynamic coastal region and a lagging hinterland putting one more layer of pressure on the Chinese government.

What this has to do with China's presence and investments in Europe? Trends of Chinese outbound investments can be affected by the country's economic growth as well as its need to turn its resources to domestic consumption or developing its welfare system. Since Europe has only a relatively small share of China's outbound investments, effects of these factors on the level of investment are likely to be amplified.

Crocodile in the Yangtze

When looking at Chinese development and investment, many focus on the role of the state and try to win the goodwill of the Chinese government to promote Chinese investment in their economy. They often fail to notice a new player in the Chinese economy that will be more important and interesting in the future: the Chines global private enterprise. Huawei, with its large greenfield investments in Hungary and Spain, and Geely, the Chinese company buying Volvo, are two examples. Alibaba, the operator of the world's largest global e-commerce platform for small and medium sized businesses is another example.

Why are these companies interesting and important? Because they are the fastest growing new cornerstones of the Chinese economy, and they are also global players already. Moreover, they think and act differently than Chinese state owned companies, and in an environment less supportive towards private businesses than that of their global competitors, they focus more on their customers. In his recent book, Porter Erisman, former vice president of Alibaba, let us peek into this new kind of companies.

Alibaba started as a modest website to make Chinese businesses visible to the world on the internet. Realizing the opportunities, its founder, Jack Ma, wanted to build a global e-commerce portal based in China but serving customers all over the world. Alibaba is a completely private enterprise. It has never got subsidies from the state. Instead, the early growth and development of the company was financed by Japanese and American venture capital. As the company grew, the founders realized the need for professional management and they hired experienced professionals like Savio Kwan, COO of Alibaba. Born in Hong Kong, he studied in London and worked for GE in China bringing both Western management expertise and local Chinese experience to the company. Another example of the author of the book on Alibaba himself, Porter Erisman, a former vice president of Alibaba and one of the Americans working for the company in its early years of development (Erisman, 2015).

Alibaba is a Chinese company. Its headquarter is still in Hangzhou, the home town of its founder. On the other hand, it is also a global company. When on September 19, 2014, Alibaba has done the largest IPO in history, it was in New York. Leaders of Alibaba are familiar with the realities of the Chinese economy and they adapt to that but they think and act like any global company. Even more so, because in fact, they can rely less on the state, not more than their Western counterparts. If we want to attract Chinese investment to Europe and Hungary in the future, we need to think value for the customer instead of pleasing the Chinese government.

Hungary and China – an evolving strategic partnership

Hungary's solution to the problem of a divided Europe is accepting reality and abandoning "the illusion of federalism" instead of following the utopia of a federalist Europe, and accepting China's lead (Cabinet Office of the Prime Minister, 2017; Lui, 2017). The idea of multipolarity is also present in the implementation of Hungary's eastern opening strategy. Aligned with the Chinese interest of forging closer ties with East Central European Member States instead of dealing with a unified European Union, Hungary pursues a stronger strategic partnership between China and East Central Europe (MTI 2016d; 2016a; Miniszterelnök.hu, 2016).

Hungary's eastern opening strategy is already generating results. One example is the refurbishment of the Budapest–Belgrade railway line to be implemented by a Chinese-Hungarian joint venture (Ministry of Foreign Affairs and Trade, 2016). Another example is Chinese telecom giant Huawei which employs more than 2000 people in

Hungary already (Ministry for National Economy, 2016) with further talks about an increased cooperation including Huawei's participation in the Digital Welfare Programme of the Hungarian Government (MTI, 2016c). Several Chinese enterprises also seek cooperation with Hungary in the fields of e-mobility, intelligent transport systems, autonomous cars, and smart cities (Ministry for National Economy, 2017) The Hungarian Government also signed a partnership agreement with Chinese automotive industry supplier Yanfeng Automotive last year (MTI, 2016b).

This year also started with success in Chinese–Hungarian relations. The Hungarian Government has signed a strategic cooperation agreement with the Bank of China, accompanied by other agreements between the Bank of China and the National Bank of the Budapest Stock Exchange, the Government Debt Management Agency, and Eximbank (MTI, 2017a). As a result of the agreement, the Bank of China will be developing closer relations with the Hungarian Investment Promotion Agency and Eximbank, and will also be promoting Hungary in China as a European investment destination (MTI 2017b).

Conclusions and recommendations

Chinese investments in Europe grew rapidly in the last few years but Chinese outbound FDI in Europe still represents a small share in both total Chinese outbound FDI and total FDI in Europe. While China's ambitious One Belt One Road initiative shows an intention to further develop economic relations between China and Europe, there are also uncertainties ahead.

Chinese investments have been concentrated on the European core with the United Kingdom, Germany, and France as the main targets but the regional scope of Chinese investments in Europe is already expanding. While one of the main motivators of China's European investments is gaining access to technology, successful investments require synergy between partners with the Chinese partner also contributing to competitiveness beyond merely providing finance.

There are also concerns about Chinese investments in Europe. The largest Chinese investors are state owned companies and letting them gain access to European technology and exerts may even pose a national security risk beyond the economic concerns. Another problem is trading fundamental European values and political interests for potential economic benefits. The division among Member States of the European Union on these issues also poses a risk and China has not been shy to use this division to its own advantage.

On the other hand, China is the second largest economy of the world and an integral part of the world economy so that developing economic relations between Europe and China, and specifically, between Hungary and China benefits both sides. With its One Belt One Road initiative, China expressed its intention for a closer cooperation. It is best to take the OBOR initiative as an opening bid for doing business with China on mutually beneficial terms but finding and negotiating for our own benefits are not China's responsibility. The best European, and also Hungarian, strategy, therefore, is developing our own strategies along our own economic and political interest and negotiate lasting deals with China whenever our interests are aligned. It is also advisable not to let China divide the EU and not to trade European unity and values for short term benefits. China can be a great economic partner but like any great power, it has the tendency to expand its sphere of influence and impose it values, and political system, and interests on others. Holding back China on these fronts and doing business on mutually beneficial terms is our responsibility. Without doing our own homework, simply following China's advice will lead to serving its interests and giving up our own.

Notes

[1] The views and opinions expressed in this article are those of the author and do not necessarily reflect the official policy or position of the Central Bank of Hungary or the Doctoral School of Geography.

[2] Deutsche Bank reports the transaction as a deal in the consumer sector at a value of 1165 million dollars

[3] Deutsche Bank reports China Petroleum & Chemical Corp. as buyer of Talisman Sinopec Energy UK Ltd.

[4] In a Deutsche Bank report, the acquisition of Volvo Personvagnar AB by Zhejiang Geely Holding Group for 1.8 billion dollars is listed but the two transactions are most likely the same as Geely acquired Volvo from Ford (Hansakul–Levinger, 2014:14).

[5] Despite developing welfare programmes, family is still the primary source of eldercare in China where the constitution says that "children who have come of age have the duty to support and assist their parents" (Lou, 2015).

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