# Chinese OFDI in Europe and the Central and Eastern European region in a global context

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## 1. Introduction

In parallel with the new challenges the Chinese economy is facing, China's role in the global economy is changing too. Chinese outward foreign direct investment (OFDI) has increased in the past decades, however, in the last few years this process accelerated significantly. In 2012, China became the world's third largest investor – up from sixth in 2011 – behind the United States and Japan with an OFDI flow of 84 billion US dollars and it still hold its position (90.2 billion US dollars in 2013 according to Chinese statistics). Several factors fuelled this shift, including the Chinese government's wish for globally competitive Chinese firms or the possibility that OFDI can contribute to the country's development through investments in natural resources exploration or other areas (Sauvant – Chen, 2014, pp. 141-142).

Although the majority of Chinese OFDI is directed to the countries of the developing world, Chinese investments into the developed world, including Europe increased significantly in the past decade. According to *Clegg and Voss*, Chinese OFDI to the European Union increased from 0.4 billion US dollars in 2003 to 6.3 billion US dollars in 2009 with an annual growth rate of 57 percent, which was far above the growth rate of Chinese OFDI globally. While the resource-rich regions remained important for Chinese companies, they started to become more and more interested in acquiring European firms after the financial and economic crisis. The main reason for that is through these firms Chinese companies can have access to important technologies, successful brands and new distribution channels, while the value of these firms has fallen due to the crisis, too (Clegg – Voss, 2012, pp. 16-19.).

The aim of the paper is to analyse Chinese OFDI to Europe by presenting its main trends, patterns and motivations with a special focus on the impact of these investments in the EU and European countries, respec-

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tively. In order to assess the role and importance of OFDI from China towards Europe, it must be evaluated within a global context, taking into account its geographical, as well as sectoral distribution.

After the introductory section, the *second chapter* examines Chinese foreign direct investment globally, taking into account trends, patterns and investors' potential motivations when choosing a specific destination for their placements. In the *third chapter*, sectoral preferences and global dispersion of Chinese OFDI will be detailed, relating major investment areas, recipient countries and regions. The *fourth chapter* will be devoted to outlining Chinese investments in Europe. By detailing certain major investments of strategic importance the authors will try to debunk myths on China as a neo-colonial power using its economic "soft power" to influence recipient countries' political decisions. Chinese investments in sovereign bonds or European financial institutions during the crisis will be evaluated, too. The *fifth chapter* deals briefly with a new phenomenon, Chinese OFDI in the Central and Easter European region. In the *sixth chapter* the authors will conclude their investigation by arguing that although the majority of Chinese investments are directed to the developing world, European countries are at the forefront of Chinese OFDI to developed countries. Based on analysed patterns and observed Chinese preferences, the authors will try to formulate policy recommendations for the attraction of Chinese investors.

The authors will usually take into account foreign direct investment by mainland Chinese firms (where the ultimate parent company is Chinese), unless marked explicitly that due to data shortage or for other purposes they deviate from this definition. Since data in FDI recipient countries and Chinese data show significant differences, the two data sets will usually be compared to point out the potential source of discrepancies in order to get a more complex and nuanced view of the stock and flow of investments. For Chinese global outflows statistics from Chinese Ministry of Commerce (MOFCOM) and UNCTAD will be taken into account and compared.

## 2. Trends, patterns and motivations of Chinese OFDI

As recently the Chinese economy is facing new challenges and its economic strategy is transforming, the country's global investment position is altering as well, however, a bit more than a decade ago the amount of Chinese OFDI was almost negligible.

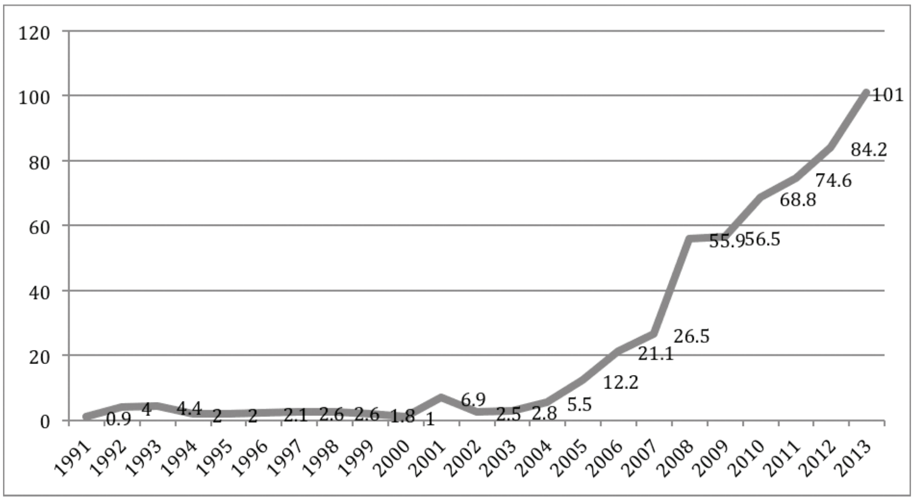
[2]FDI from Hong Kong Special Administrative Region (SAR), from the Macao SAR, from Taiwan or from any offshore tax haven will not be taken into consideration.

In hand with the “Open Door” policy reforms, the Chinese government encouraged the country’s investment abroad to integrate China to the global economy, although the only entities allowed to invest abroad were state-owned enterprises (SOEs). The total investment of these first years was not significant and concentrated to the neighbouring countries, mainly to Hong Kong. The regulations were liberalized after 1985 and a wider range of enterprises – including private firms – was permitted to invest abroad. After Deng Xiaoping’s well-known journey to the South, overseas investment increased dramatically, Chinese companies established overseas divisions almost all over the world, concentrated mainly in natural resources. Nevertheless, according to UNCTADstat, Chinese OFDI averaged only 453 million US dollars per year between 1982 and 1989 and 2.3 billion between 1990 and 1999.

In 2000, before joining the World Trade Organization (WTO), the Chinese government initiated the *go global* or *zou chu qu* policy, which was aimed to encourage domestic companies to become globally competitive. They introduced new policies to induce firms to engage in overseas activities in specific industries, notably in trade-related activities. In 2001 this encouragement was integrated and formalized within the $10^{th}$ five-year plan, which also echoed the importance of the *go global* policy (Buckley et al 2008). This policy shift was part of the continuing reform and liberalization of the Chinese economy and also reflected Chinese government’s desire to create internationally competitive and well-known companies and brands. Both the $11^{th}$ and $12^{nd}$five-year plan stressed again the importance of promoting and expanding OFDI, which became one of the main elements of China’s new development strategy.

Chinese OFDI has steadily increased in the last decade (see *Figure 1.),* particularly after 2008, due to the above-mentioned policy shift and the changes in global economic conditions, that is, the global economic and financial crisis. The crisis brought more overseas opportunities to Chinese companies to raise their share in the world economy as the number of ailing or financially distressed firms has increased (Artner, 2010, p 933). While OFDI from the developed world decreased in several countries because of the recent global financial crisis, Chinese outward investments increased even greater: between 2007 and 2011, OFDI from developed countries dropped by 32 percent, while China’s grew by 189 percent (He-Wang, 2014, p. 4; UNCTAD 2012). According to the World Investment Report 2013, in the ranks of top investors, China moved up from the sixth to the third largest investor in 2012, after the United States and Japan – and the largest among developing countries –as outflows from China continued to grow, reaching a record level of 84 billion US dollars in 2012. Thanks largely to this rapid increase of China's outward FDI in recent years, China also became the most promising source of FDI when analysed FDI prospects by home region (UNCTAD 2013, p. 21).

**Figure 1. China's outward FDI flows, 1991-2013 (USD billion)**




Source of chart data: Data for 1991-2013 are from *UNCTAD's FDI/TNC database*, available at http://unctadstat.unctad.org/ (the data before 2006 doesn't include financial OFDI, that is, OFDI in financial services). Data for 2013 is the estimation of UNCTAD's *Global Investment Trends Monitor*, available at http://unctad.org/en/PublicationsLibrary/webdiaeia2014d5_en.pdf, which includes financial FDI outflows. According to MOFCOM, Chinese OFDI increased to 90,2 billion US dollars in 2013, however, this data excludes financial FDI flows.

According to MOFCOM statistics, Chinese companies invested overseas in 5090 enterprises, in 156 countries and regions in 2013. Chinese non-financial OFDI amounted to 90.17 billion US dollars, up by 16.8 percent over last year, of which equity investments and other investments were 72.77 billion, accounting for 80.7 percent, and earnings reinvested were 17.4 billion, accounting for 19.3 percent. As of the end of 2013, China's non-financial direct investment overseas totaled 525.7 billion US dollars. While more and more Chinese companies are investing overseas, Chinese OFDI raises concerns and therefore causes strengthening protectionism against it, especially in the developed world. Several experts believe that Chinese OFDI could be greater if host countries were more hospitable. According to *He and Wang*, there are several reasons for that:

1. state-owned enterprises (SOEs) are the dominant players in Chinese OFDI and they are often viewed as a threat for market competition as they supported by the Chinese government;
2. foreign companies often complain that Chinese companies may displace local companies from the market as they bring technology, resources and jobs away;
3. there are fears about Chinese companies' willingness to adapt to local environment, labor practices and competition.

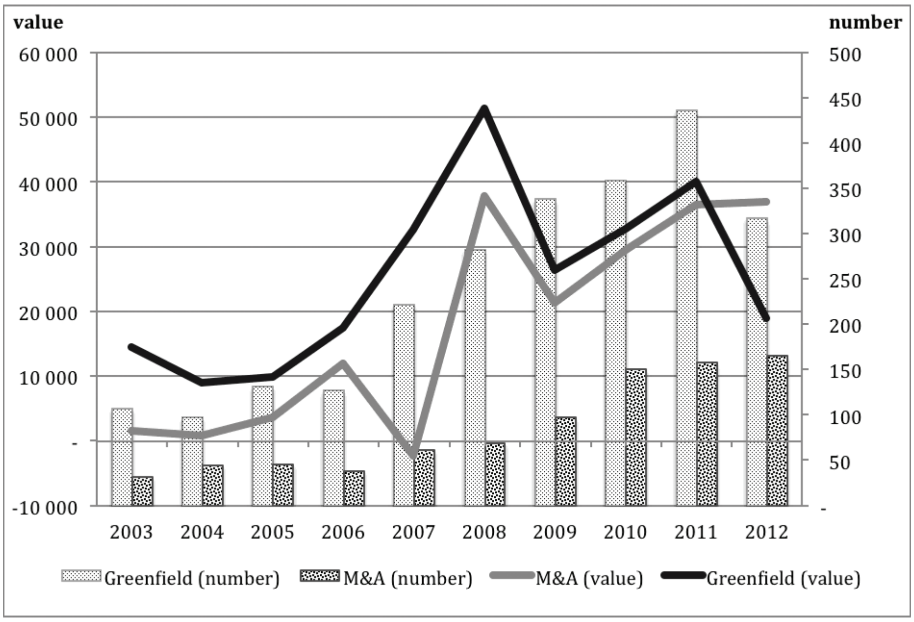
Although the above-mentioned problems indeed exist, they are overestimated as Chinese companies are willing to accommodate to the international rules of investment (He-Wang, 2014, p. 4-5). According to *Scissors*, if it is about national security, the role of Chinese ownership status is overblown as Chinese rule of law is weak, which means that a privately owned company has to face as much pressure and constraint as its state-owned competitor (Scissors, 2014, p. 5). Nevertheless, it is worth to differentiate between SOEs, which has two types: locally administered SOEs (LSOEs) and centrally administered SOEs (CSOEs). Most of the LSOEs operate in the manufacturing sector and they are facing competition from both private companies and other LSOEs, while CSOEs are smaller in number but more powerful as they operate in monopolised industries such as finance, energy or telecommunication (He-Wang, 2014, p. 6).

Although the share of private firms is growing, SOEs still account for the majority – more than two-thirds – of total Chinese outbound investments, however, the range of investors is broader, next to state-owned and private actors it includes China's sovereign wealth fund and firms with mixed ownership structure. The role of SOEs seems to be declining in the past few years, although the government will continue to emphasize their importance as they rely on the revenue, job creation and provision of welfare provided by the SOEs (He-Wang, 2014, p. 12).

According to the *go global* strategy, Chinese companies should evolve into globally competitive firms, however, Chinese companies go abroad for varieties of reasons. The most frequently emphasized motivation is the need for natural resources, mainly energy and raw materials in order to secure China's further development (resource-seeking). Mutatis mutandis, they also invest to expand their market or diversify internationally (market-seeking) (Artner, 2009, p 1044). Nevertheless, services such as shipping and insurance are also significant factors for OFDI for Chinese companies if they export large volumes overseas (Davies, 2013, p 736). Despite China's huge labour supply, some companies move their production to cheaper destinations (efficiency-seeking). Recently, China's major companies also looking for well-known global brands or distribution channels, management skills, while another important reason for investing abroad is technology acquisition (strategic asset-seeking).

*Scissors* points out that clearer property rights – compared to the domestic conditions – are also very attractive to Chinese investors (Scissors, 2014, p. 4), while *Morrison* highlights an additional factor, that is, China's accumulation of foreign exchange reserves: instead of the relatively safe but low-yielding assets such as US treasury securities, Chinese government wants to diversify and seeks for more profitable returns (Morrison, 2014, p. 15-16).

**Figure 2. The value and number of China's outward cross-border M&A purchases and greenfield FDI projects, 2003-2012 (USD million)**




Source of chart data: UNCTAD's World Investment Report 2013 Annex Tables, available at http://unctad.org/en/pages/DIAE/World%20Investment%20Report/Annex-Tables.aspx

Regarding the entry mode of Chinese outward investments globally, greenfield FDI is continues to be important, but there is a trend towards more mergers and acquisition (M&A) and joint venture projects overseas. Overall, greenfield investments of Chinese companies outpace M&As in numerical terms, however, greenfield investments are smaller in value in total (see *Figure 2.)* as these include the establishment of numerous trade representative offices. The weight of M&A has risen steadily in the past years: M&As accounted for only 18 percent of Chinese OFDI in 2003, while nowadays it is around two-thirds of China's total investments overseas (Nicholas, 2014, p. 104 and Rosen-Hanemann 2009). Although joint venture (both contractual and equity) as an entry mode for Chinese outward investments accounted for the largest share in the 90s and at the beginning of the 2000s, its role became less significant in the past years, accounting for around 20 percent of China's total OFDI[2] (Davies, 2013b, p. 71).

**3. Global dispersion and sectoral preferences of Chinese OFDI**

China's OFDI has become more sectorally diversified in the past years: mining and manufacturing dominated Chinese investments overseas with a share of over 60 percent till 2003, the following years saw the growing share of high technology, infrastructure and heavy industry, while the sectoral preferences of Chinese OFDI lately turned to the tertiary sector[3], that is, to business services and finance primarily and also health care, media and entertainment. *Clegg and Voss* point out that this progress can be regarded as part of the internationalization process of Chinese companies: firms from business services and finance follow their major domestic clients or prepare their entry to the new market (Clegg-Voss, 2012, pp. 18-19). According to MOFCOM, in terms of industrial breakdown, in 2013 almost 90 percent of the investment flew to commercial service industry (leasing and business services), mining industry, wholesale and retail industry, manufacturing industry, construction industry and transportation industry (see *Figure 3.*). Nevertheless, OFDI in natural resources will remain an important component of Chinese investments in the future as Chinese companies still have a huge interest in extraction investments overseas due to the on-going urbanization process and the limited domestic deposits of most resources (Rosen-Hanemann, 2009, pp. 9-10).

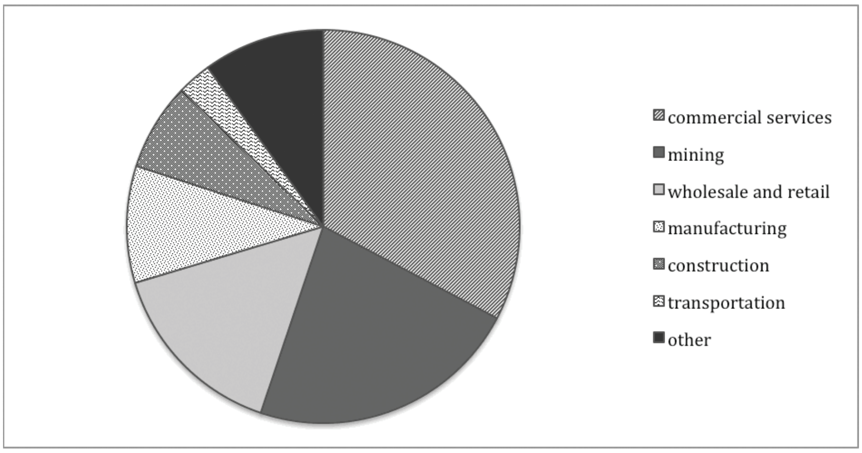
As *Figure 3.* shows, commercial service industry (leasing and business services) is the largest category of Chinese OFDI, however, the exact nature of these investments is uncertain and it is likely that a large share of these investments are redirected to the manufacturing or mining sectors (He-Wang, 2014, p. 7). *Wang* tried to follow the final destination and actual

[2]According to MOFCOM statistics, the outward equity joint venture FDI was 21.7 billion US dollars in 2012, while the realized value of contractual joint ventures was 2.3 billion US dollars in the same year. Its share of total Chinese OFDI was 19.4 and 2.1, respectively.

[3]For example, according to MOFCOM data, in 2010, almost 80 percent of Chinese OFDI was destined to the services sector, 13 percent of total OFDI stock invested in financial services.

industries of Chinese OFDI by examining project-level data and found that despite of the official listing mining and manufacturing are the major attractions for Chinese investors (Wang, 2013). Another interesting finding is that overseas investments in the manufacturing sector were mostly made by the private sector and LSOEs, while investments in the mining sector were dominated by CSOEs (He and Wang, 2014, p. 7).

**Figure 3. Sectoral distribution of Chinese OFDI, 2013**




Source of chart data: MOFCOM's Brief Statistics on China Direct Investment Overseas in 2013, available at http://english.mofcom.gov.cn/article/newsrelease/press/201401/20140100463687.shtml

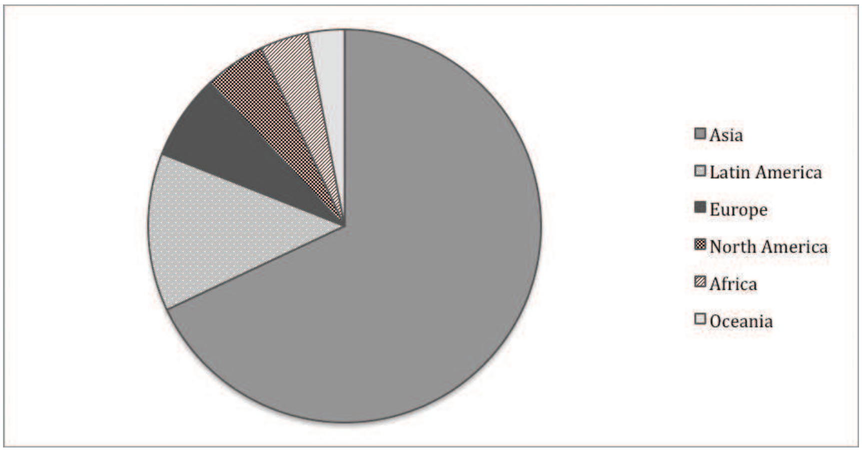
The sectoral distribution of Chinese outward FDI has varied between provinces, while also the level of diversification between the above-mentioned sectors are diverse among the various provinces or province-level units (Davies, 2013b, pp. 50-51).

Regarding geographical distribution, Asia continues to be the largest recipient, accounting for nearly three-quarters of total Chinese OFDI[5]. According to MOFCOM statistics, Chinese OFDI to Hong Kong, the ASEAN, the EU, Australia, the US, Russia and Japan reached 65.45 billion US dollars in 2013, accounting for 72 percent of China's total foreign direct investments overseas, up by 9.1 percent year-on-year. Investments in Hong Kong, EU and Japan fell by 6 percent, 13.6 percent and 23.5 percent respectively, while investments in Russia, the US, Australia and the ASEAN reached 4.08 billion (+ 518.2 percent), 4.23

[5]Within the region, Hong Kong is the largest destination, attracting 58.4 percent of China's total FDI outflows.

billion (+ 125 percent), 3.94 billion (+ 82.4 percent) and 5.74 billion (+ 29.9 percent) US dollars, respectively. The direction of outward FDI has also varied between provinces due to geographical proximity (border provinces), coastal or inland positions (access to world market) and wealth differences. Chinese diaspora in South East Asia and North America – and their province-level connections – also plays an important role in the direction of Chinese OFDI (Davies, 2013, pp. 49-50).

**Figure 4. Geographical distribution of Chinese OFDI stock, 2012**




Source of chart data: MOFCOM and BBVA Research (BBVA, 2013, pp. 6-7)

If we analyse the geographical distribution of Chinese OFDI stock in MOFCOM statistics (which identifies only the first destination of investments), we can learn that a major part of investments is received by Hong Kong and the Caribbean offshore financial centres: the British Virgin Islands, the Cayman Islands and Hong Kong usually account for the two-thirds of China's investment flows and stocks. This high share is related to a phenomenon called *round-tripping*. Round trip investments are typically following the same pattern: a Chinese resident establishes or takes control of an offshore holding company, and use this offshore company to control a Chinese company by either direct acquisition or captive contractual arrangement (Chao-Xu, 2008, pp. 1-2). In this case, the investment is placed in a special purpose entity – a transit or intermediary destination – outside China only to flow it back in the form of inward FDI to China to benefit from fiscal incentives designed for foreign investors. Round-tripping therefore might (mis)lead experts to overestimate overall Chinese OFDI.

Some part of Chinese OFDI to Hong Kong stays in the PRC's Special

Administrative Region as Hong Kong also used as a platform for making further investments in other countries, especially developed ones. During the examination of the actual final destination of Chinese OFDI, *Wang* found that developed countries receive more Chinese investments than developing economies: according to his project-level data analysis, 60 percent of Chinese ODI went to developed economies like Australia, Hong Kong, the United States, Germany, and Canada (Wang, 2013). *Davies* warns that an underestimation is equally possible if not attaching enough importance to the growing role of private investors, who might opt for circumventing the official approval process and use their capital concentrated overseas (Davies, 2013a, p.757).

Being one of the top investors of the developing world, since 2008 Chinese investment increased substantially in developed economies as well. Although this increase is impressive by all means, China still accounts for less than 5 percent of total FDI inflows into the EU or the US. In the case of developed economies Chinese investment are less dominated by natural resource seeking or trade-related motives but more concerned with the wide range of objectives, including market-, efficiency- and strategic assets-seeking motives (Rosen-Hanemann, 2013, p. 69 and UNCTAD, 2013, p. 46).

As *Clegg and Voss* note, the industry-by-country distribution of Chinese OFDI is difficult to determine from Chinese statistics. However, based on their findings, it can be stated that Chinese investments in mining industry are taking place mainly in institutionally weak and unstable countries with large amounts of natural resources and that these investments are normally carried out by SOEs. Investments in manufacturing usually take place in large markets with low factor costs, while Chinese companies seek technologies, brands, distribution channels and other strategic assets in institutionally developed and stable economies (Clegg-Voss, 2012, p. 19). In developed economies Chinese SOEs usually have the majority of deal value but non-state firms make the greater share of deals (Rosen-Hanemann, 2013, p. 71). In addition to greenfield investments and joint ventures, China's merger and acquisition (M&A) activity in developed countries has recently gained a momentum and continue an upward trend since more and more Chinese firms are interested in buying overseas brands to strengthen their own. However, some attempted Chinese acquisitions failed[6] in the United State and Australia in recent years (Davies, 2013, p. 36).

[6]In the U. S. CNOOC tried to acquire UNOCAL unsuccessfully and Haier and Huawei also failed to compound important deals. In Australia, Chinalco and Minmetals Resources failed to clinch the planned acquisitions (Davies, 2013b, p. 37).

**4. Chinese FDI in the EU: general overview, effect of the crisis**

The European Union has been the major destination for foreign direct investments in the last twenty years, with a preponderance of intra-European FDI, extra-European FDI representing only about one-third of the total sum. Compared to the aggregate, Chinese foreign direct investment stock in the EU remains insignificant. However, regarding the trends and dynamism of Chinese inward FDI, the economic "footprint" and impact of Chinese foreign direct investment in the EU is indisputably expanding.

Although Chinese investors continue to breed anxiety in Europe, several experts point out that growing European investments are simply part of the going global strategy rather than a specific grand design related to Europe (Hanemann, 2013). *Hanemann* also points out commercial reasons behind most investments: the acquisition of rich-world brands and technology to increase competitiveness, money-saving by moving higher value-added activities in countries where regulatory frameworks are more developed, or by acquiring firms cheaper due to the crisis or due to a stronger renminbi (Hanemann, 2012). So the crisis only accelerated the long-term Chinese strategy of going global and moving up the value chain (Jonas Parello-Plesner, 2013, p.19).

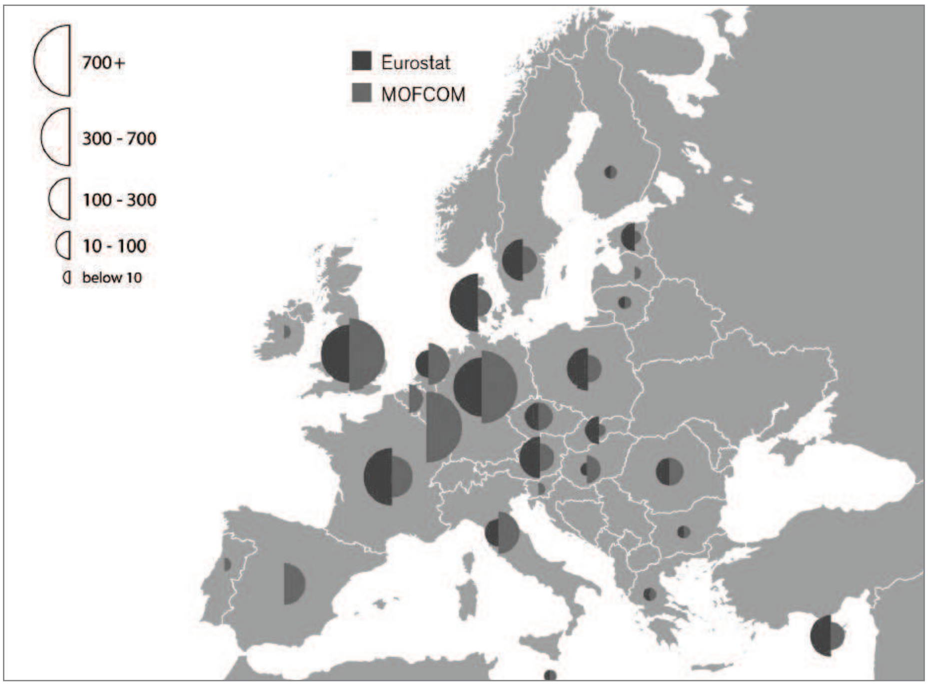
According to Eurostat statistics, in 2009 and 2010, Chinese FDI stock into the EU 27 amounted to 5.9 and 6.1 billion euros respectively. However, in 2011, Chinese FDI stock reached 18.5 billion euros and by the end of 2012, 26.8 billion euros (still only 0.068 percent of total stocks held by the rest of the world in the EU27)(Eurostat News Release, 12/2014**)**. The sudden surge is due to large-scale acquisitions in utilities, consumer products, industrial machinery, and infrastructure.

However, Chinese statistics show a similar trend, but different numbers. MOFCOM has not yet released data for 2011 and 2012 when investment trends became more dynamic and country rankings changed according to European data. Chinese OFDI stock in Europe (but taking into account European countries that are not member states of the EU like Albania, Azerbaijan, etc.) amounted to 3352.72 billion US dollars and 6760.19 billion US dollars in 2009 and 2010. Outward Chinese FDI stocks in major EU economies reached 1689.3 billion US dollars in the UK, 1523 billion US dollars in France, 1421.3 billion US dollars in Germany and 336.1 billion US dollars in Sweden (MOFCOM, 2010). Taking into account MOFCOM statistics, in 2010, the flow of Chinese OFDI to Europe doubled over that in 2009 (Davies, 2012, p.3).

In order to highlight the difference between Chinese and European statistics, *Figure 5.* showsan illustration of Chinese OFDI in the EU in

2009 in million euros according to *Clegg and Voss,* based on Eurostat, NBS (National Bureau of Statistics of China), MOFCOM, SAFE (State Administration of Foreign Exchange) (2011) data (Clegg-Voss, 2012, p. 23).

**Figure 5. Chinese OFDI in the EU, 2009 (EUR million)**




Source of data: Eurostat (2011b) and NBS, MOFCOM and SAFE (2010) available at http://www.chathamhouse.org/sites/default/files/public/Research/Asia /0912ecran_cleggvoss.pdf

A combined analysis of both data sources suggests that Chinese investment in Europe is intensifying. It is more than probable that this dynamism is just the beginning of a long-term process (Söderman-Jakobsson-Soler, 2008 and Cui-Jiang, 2009). The European Union Chamber of Commerce in China questioned a sample of 74 Chinese enterprises that had already invested in the EU. They found that 97 percent of these firms intend to make future investments in the EU, mostly even higher amounts than before. (European Chamber, 2013, p.5.) However, unfamiliarity with local conditions might keep some investors away from European markets (Shixue, 2013): 78 percent of the above-mentioned 74 firms noted that they were facing bureaucracy and high costs-related operational difficulties in the EU and 48 percent were confronted with regulatory approval obstacles (European Chamber 2013).

*4.1. Bond purchases: is China willing to save the EU?*

European markets seem more and more attractive for Chinese investors because investing in Europe is perfectly in line with long-term Chinese goals: gain access to a large consumer market, high value-added technologies in a relatively stable, well regulated destination.

The Eurozone crisis definitely attracted Chinese investors due to falling prices. However, China is not willing to play the role of the Eurozone's rescuer, as some might assume. As Europe is China's largest trading partner and export destination, Chinese leaders throughout the crisis voiced their support: a robust and financially stable Europe is in China's interest. Yet when it comes to define the actual size of Chinese financial investments, uncertainty is prevailing. China definitely possesses the means to financially back the Eurozone. Chinese foreign exchange reserves reached a record 3.88 trillion in 2013 (Hanemann, 2014). But Chinese willingness to give a helping hand is determined by its investors' risk-averse investment strategy. Actual numbers on bond purchases is practically impossible to assess: China only publishes the total amount of its foreign exchange reserves, not the exact composition. So China officially has never given data on its stake in public debt financing in Europe. The other side, the European Central Bank does not track the nationality of foreign investors in the debt market (Parello-Plesner, 2012, p.12). Given the lack of precise data, experts try to resort to estimates.

The European rescue fund, European Financial Stability Facility (EFSF) indicates Asian investors separately. Since EFSF ratings[7] are acceptable for risk-averse investors, it is logical to suppose that we can ascribe most of Asian investments in EFSF issuances to China. However, in 2011 (its first year of operation), Asian investors bought 40 percent of the EFSF issuances, Japan (being transparent on its purchases) accounting for half of the Asian total. Parello-Plesner's assumption is that China accounts for 40 percent of the Asian total, 16 percent of all investors buying issuances (altogether estimated at 5.6 billion euros). Another important assumption claims China holding approximately a quarter of its foreign exchange reserves in European bonds. This would mean several tens of billions of

[7]EFSF has been assigned the best possible credit rating by Fitch Ratings (AAA). EFSF has been assigned a 'AA+ ' rating by Standard & Poor's and a Aa1 rating by Moody's. EFSF has also been assigned the highest possible short term rating from the credit rating agencies – Standard and Poor's 'A-1+'; Moody's (P) P-1 and Fitch Ratings 'F1+'. (EFSF Frequently Asked Questions, p.3.)

EFSF bond purchases. However, in reality, China prefers placing its money in unanimously triple AAA-rated countries like Germany rather than taking the risk of investing in indebted, riskier countries (Parello-Plesner, 2012).

The original plan was to leverage the EFSF up to 1 trillion euros using outside financial resources, among others Chinese investments (Spiegel Online, 2011). This grand design was never realized among others because China was reluctant to play a more decisive role in rebuilding the EU's financial stability. Bailing out EU countries is difficult to justify in the eyes of Chinese people. Why would Chinese pay for Europeans to retire early when they do not have an adequate pension system themselves? Another rightful question the Chinese population might pose: if Germany is not willing to contribute more, why should China step in (Yongding, 2011)?

*4.2. Chinese investments in the EU: sectoral and geographical distribution*

China's strong desire for success envisions the next phase of development building on innovation and high and green technology. In line with these ideas we've seen large-scale Chinese acquisitions in the chemicals sector: BorsodChem became part of the Wanhua Industrial Group (borsodchem.hu, 2011); and the automotive industry: Rover Group belongs to the Shanghai Automotive Industry Corporation, Chinese Geely Automobile Holdings owns Volvo and Chinese also have a share in what is left of the Swedish group Saab. Great Wall Motors Company has opened a new plant in Bulgaria and thus became the first Chinese automaker to assemble cars in the European Union (novinite.com, 2012). Romania has also been attracting Chinese greenfield investments, among them a plant by Shantuo Agricultural Machinery Equipment to produce tractors.

Chinese investors have also been active in communication equipment and services, industrial machinery and equipment and renewable energy regarding the number of deals. However, since these sectors are not so capital intensive, the average deal size is smaller. Chinese have also invested in automotive components, financial services and software and IT services across Europe (Hanemann-Rosen, 2012, p. 40). With respect to investment amount, chemicals, plastics and rubber, utility and sanitary services, and automotive original equipment manufacturers (OEM) and components rank highest (Ibid., p. 41).It must be added that access to resources remains of crucial importance in the developed markets as well, illustrated by recent stakes acquired in Gaz de France and Energias de Portugal (Bugge, 2011 and The Portugal News Online, 2011).

*Gao Xiqing* from China Investment Corporation, China's sovereign wealth fund (CIC) claimed in an interview with Xinhua that Europe is an optimal destination for infrastructural investments as well. These

**Figure 6. Chinese OFDI in the EU by industry, 2000-2011 (USD million)**

| | Sector | Value (USD mn) | | | Number of Projects | | |
|---|---|---|---|---|---|---|---|
| | | Greenfield | M&A | TOTAL | Greenfield | M&A | TOTAL |
| 1 | Chemicals, Plastics & Rubber | 126 | 3,505 | 3,631 | 13 | 9 | 22 |
| 2 | Utility and Sanitary Services | 0 | 3,259 | 3,259 | 0 | 1 | 1 |
| 3 | Automotive OEM & Components | 655 | 1,961 | 2,615 | 23 | 12 | 35 |
| 4 | Coal, Oil & Gas | 18 | 1,603 | 1,621 | 4 | 7 | 11 |
| 5 | Communications Equip. & Services | 1,180 | 177 | 1,357 | 95 | 5 | 100 |
| 6 | Transportation Services | 784 | 546 | 1,329 | 9 | 7 | 16 |
| 7 | Metals Mining & Processing | 25 | 1,200 | 1,225 | 13 | 14 | 27 |
| 8 | Consumer Electronics | 187 | 983 | 1,170 | 33 | 9 | 42 |
| 9 | Industrial Machinery & Equipment | 495 | 499 | 993 | 34 | 23 | 57 |
| 10 | Food, Tobacco & Beverages | 110 | 570 | 679 | 10 | 9 | 19 |
| 11 | Financial Services & Insurance | 495 | 31 | 526 | 26 | 2 | 28 |
| 12 | Real Estate | 146 | 340 | 486 | 4 | 1 | 5 |
| 13 | Pharmaceuticals | 21 | 280 | 300 | 4 | 3 | 7 |
| 14 | Electronic Equip. & Components | 133 | 152 | 285 | 22 | 5 | 27 |
| 15 | Software & IT Services | 256 | 13 | 269 | 21 | 5 | 26 |
| 16 | Aerospace, Space & Defense | 79 | 174 | 253 | 7 | 4 | 11 |
| 17 | Textiles & Apparel | 137 | 96 | 233 | 8 | 4 | 12 |
| 18 | Alternative/Renewable Energy | 145 | 84 | 229 | 45 | 7 | 52 |
| 19 | Healthcare & Medical Devices | 30 | 63 | 93 | 9 | 2 | 11 |
| 20 | Paper, Printing & Packaging | 74 | 0 | 74 | 2 | 1 | 3 |
| 21 | Leisure & Entertainment* | 48 | 0 | 48 | 3 | 0 | 3 |
| 22 | Other Transport Equipment | 31 | 15 | 46 | 4 | 1 | 5 |
| 23 | Business Services | 43 | 1 | 44 | 13 | 2 | 15 |
| 24 | Minerals Mining & Processing | 1 | 42 | 43 | 1 | 2 | 3 |
| 25 | Semiconductors | 18 | 17 | 35 | 4.0 | 3 | 7 |
| 26 | Biotechnology | 24 | 10 | 34 | 6 | 2 | 8 |
| 27 | Consumer Products & Services | 28 | 0 | 28 | 9 | 1 | 10 |
| 28 | Furniture & Wood Products | 0 | 27 | 27 | 0 | 3 | 3 |
| 29 | Engines & Turbines | 14 | 4 | 18 | 2 | 1 | 3 |
| 30 | Construction Services | 6 | 0 | 6 | 4 | 0 | 4 |
| | **Total** | **5,306** | **15,650** | **20,957** | **428** | **145** | **573** |

Source: Rhodium Group / Hanemann-Rosen (2012) p.40, available athttp://rhg.com/wp-content/uploads/2012/06/RHG_ChinaInvestsInEurope_June2012.pdf

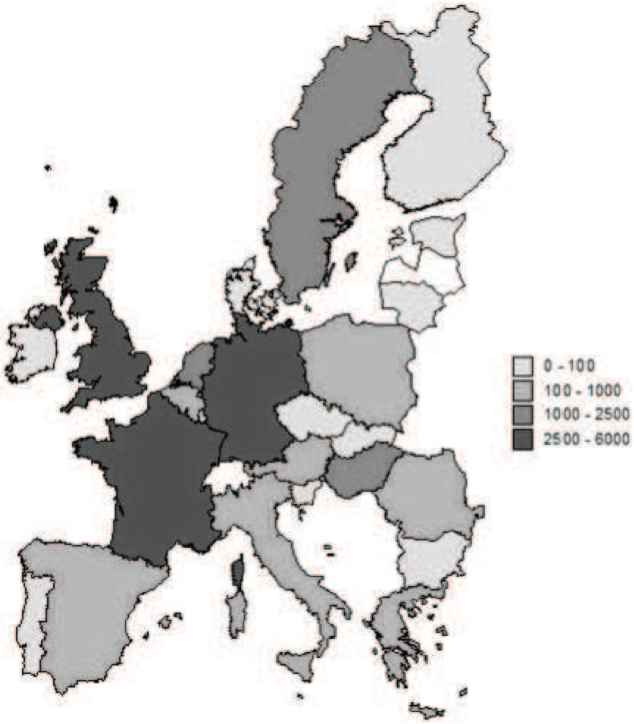
investments would suit the Chinese sovereign wealth fund's strategy since they require massive funds but have slower yields and European governments have modified taxes and regulatory policies to attract investors from outside in order to recapitalize their economies (Global Times Canada, 2013). In line with that, in 2012, CIC purchased an 8.68 percent stake in British utility company Thames Water for 1.8 billion US dollars, and it acquired a 10-percent stake in the operator of London's Heathrow Airport for 720 million US dollars. Another emblematic infrastructural project was the successful COVEC (China Overseas Engineering Group) bid for the construction of a key highway meant to link Warsaw to its Western neighbor Germany. This investment melted into thin air in 2011 when COVEC failed to pay its Polish subcontractors referring to soaring prices (Reuters Online, 2011).

"Trying to bring in Chinese workers was one of the reasons why that investment went sour", said Eberhard Sandschneider of the German Council on Foreign Relations (DGAP) in Berlin. "One of the lessons Chinese investors will have to learn is that they have to adapt to the local market. And that means adapting to local laws." (Spiegel Online, 2012). The creation of a 10 billion US dollar credit line to support Chinese investments in Central Europe is also partially devoted to infrastructural projects (as well as new technology, and renewable energy).

Another significant research element when taking a closer look at Chinese OFDI in Europe is the geographical distribution of investments. Chinese investment is very unevenly distributed among EU countries. The top recipients of Chinese FDI are traditionally France, the United Kingdom and Germany. These three countries have on average drawn 36.8 percent of annual Chinese OFDI in Europe from 2003 to 2009 (NBS, MOFCOM and SAFE (2010). France's leading role is due to a mega-investment: the Chinese sovereign wealth fund China Investment Corporation's alliance with Gaz de France in 2011.CIC paid 2.3 billion euros for a 30 percent stake in GDF's gas and oil exploration and production capacity. CIC also bought GDF's natural gas liquefaction plant in Trinidad and Tobago (Financial Times, 2011). Without this deal, France would end up being only the fourth most important host economy to Chinese money. The United Kingdom ranked second with Chinese investments targeting mostly the automotive, banking, real estate and infrastructural sectors, as well as some mining companies with assets in the developing world (Hanemann-Rosen, 2012, p.37.).Chinese FDI in Germany concentrated mainly in sectors of industrial machinery; automotive and transport; and information and communication technology (Ting-Thiess-Tianlong, 2012, p.23). This highly concentrated investment profile is probably due to market size (the attraction of a possible entry to a huge consumer market) since Chinese investors currently do not perceive the EU as an integrated single market (Clegg-Voss, 2012, p. 24). High Chinese investment in these countries is the result of "sound bilateral economic relations and effective promotion of inward investment" (Clegg-Voss, 2012, p. 24).

In order to give a general overview of the main host economies in the EU27, *Figure 7.* representsthe accumulated deal value of Chinese OFDI in the EU27 between 2000 and 2011.

**Figure 7. Chinese OFDI in the EU, 2000-2011 (USD million)**




Source: Rhodium Group / Hanemann-Rosen, available at http://rhg.com/wp-content/uploads/2012/06/RHG_ChinaInvestsInEurope_June2012.pdf

Chinese government sources refer to Luxembourg as the largest host country of Chinese FDI in Europe. This anomaly is due to the Luxembourgish business environment promoting the foundation of holding companies in the country when the actual investment is targeted to another country. (European Chamber of Commerce, 2013, p. 8). Cross-border investments often benefit from tax havens and offshore financial centers on a large-scale, making it even more difficult to discern official FDI statistics.

*4.3. Urgent need for investment, fear of China?*

European companies are in need of financial investors. Chinese investors inject money to European economies at a point when most countries are fighting mass and long-term unemployment. So Europeans are looking for job-creating greenfield investments. At the same time, Chinese investors prefer getting stakes in successful European brands with good reputation or taking over well-established enterprises. So far, it is too early to draw definitive conclusion about the nature of Chinese investments regarding job creation. Usually, mergers and acquisitions neither created a considerable amount of new jobs, nor laid off previous employers to repackage factories end technologies to China (as predicted by some) (Parello-Plesner, 2013, p.23).

The Chinese Ministry of Commerce paints a different picture, putting emphasis on greenfield investments: over 1600 Chinese enterprises in the EU have hired 50000 local workers. Rhodium Group also claims that Chinese have a definitely positive impact on European labor market: the 428 greenfield projects from 2000-2011 created an estimated 15000 new jobs. However, there are legitimate concerns related to spurring Chinese investments in the EU. These anxieties stem from the exceptional growth of China, the blurred character of state and private Chinese investors. State-owned enterprises might be more subject to political guidance directly from the Communist Party. According to Parello-Plesner, approximately 72 percent of Chinese investments in Europe originate from SOEs, but there is a growing private investor activity.

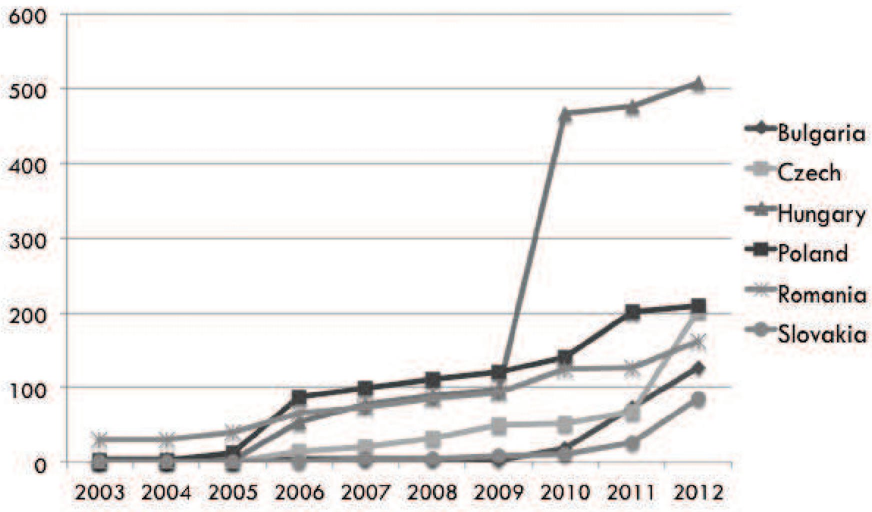
Chinese investment is often seen as a means of gaining a strategic foothold in Europe. But why are we more afraid of China accounting for only 1.4 percent of the total FDI inflow share in 2011 than we are of the United States ranking first with an overwhelming 50 percent share in the same year (Shixue, 2013)? The answer probably lies in the frequent opacity of the investors' intentions, of their relationship with the Chinese government and Communist Party. However, European market actors are also concerned regarding market access asymmetries. Since Chinese public procurement process if often closed to outsiders, European investors do not have the same room for maneuvering in China as Chinese companies in European markets.

Public perception is also of primary significance: the increasing number of Chinese mergers and acquisitions are often considered strategic takeovers where Chinese FDI is involved in unfair obtainment of technologies and knowledge Some also voice concerns over China's labor conditions and poor human rights and corporate social responsibility record (European Parliament, 2013, p. 4). Chinese companies on the other hand also have their own worries regarding European markets: the lack of an EU-level uniform regulatory framework on requirements regarding foreign investments and the high administrative costs, as well as strict visa rules and restrictive work permits might keep Chinese investors away (Shixue, 2013).

## 5. Chinese OFDI in Central and Eastern European countries

Although the Central and Eastern European region is not a priority target of the intensive Chinese FDI outflows of recent years, since the turn of the millennium Chinese investments show a growing trend here (see *Figure 8*. below).

**Figure 8. China's OFDI stock in CEEC, 2003-2012, (USD million)**




Source: CEIC China Premium Database, 2012; MOFCOM 2013.

The main recipients of Chinese investments within the Central and Eastern European region (CEE) – Hungary, Poland, Romania, Bulgaria and the Czech Republic – differ in many respects, but they have some common features as well. They have been in the process of economic catching up over the last decades, their development paths are defined mainly by the global and European powers, rules and trends and FDI has a key role in restructuring these economies. Most of the above-mentioned countries started to get more interested in Chinese relations – more properly in attracting Chinese investments and boosting trade relations – since the new millennium, however, the economic and financial crisis of 2008 drew the attention of these five countries more than ever to the potential of Chinese economic relationship.

As mentioned above, Chinese investments in Central and Eastern European countries (CEECs) are still considerably small compared to all the invested capital – or even to EU 15 – but gained momentum in recent years and also played (and plays) an important role in the region's recovery from the crisis. In the case of the selected countries – with the exception of Hungary – there is a growing demand for attracting Chinese companies in the last two to five years, while in Hungary this process has already begun after 2003. Chinese investors typically target secondary and tertiary sectors of the selected five countries. Initially, Chinese investment has flowed mostly into manufacturing (assembly), but over time services attracted more and more investment as well, for example in Hungary and Poland there are branches of Bank of China and Industrial and Commercial Bank of China as well as offices of some of the largest law offices in China, Yingke Law Firm (in Hungary in 2010, in Poland in 2012), Dacheng Law Offices (in Poland in 2011, in Hungary in 2012) (McCaleb-Szunomár, unpublished manuscript).

Typically, main Chinese investors targeting these five countries are interested in telecommunication, electronics, chemical industry, transportation and energy markets. Their investments are motivated by brand seeking, new technologies or market niches that they can fill in on European markets. The main type of Chinese FDI in the selected countries is market-seeking investment: by entering CEE markets Chinese companies will have access not only to EU market but also to markets of CIS, Mediterranean, EFTA (Wi?niewski, 2012, 121), and in interviews Chinese investors also speak about the possibility of accessing North American markets. In addition to that, there are cases of Chinese companies following their costumers to CEECs like in the case of Victory Technology (supplier to Philips, LG and TPV) or Dalian Talent Poland (supplier of candles to IKEA) (McCaleb-Szunomár, unpublished manuscript).

When searching for possible factors which make the region a favorable investment destination for China, the cost of labor is to be considered first. Labor costs are lower in the CEE region than the EU average, however, there are differences within the region – and the selected five countries – as well; unit labor costs are cheaper in Bulgaria and Romania than in Hungary, Czech Republic and Poland. These differences don't seem to really influence Chinese investors as there is more investment in Hungary, Poland and Czech Republic than in Romania and Bulgaria, however, an explanation for that can be the theory of agglomeration effect as generally OFDI in these countries is the highest in the region (McCaleb-Szunomár, unpublished manuscript). With corporate income tax rate established at 10%, Bulgaria has the most favorable tax regime in the region. Nevertheless, it is the least popular investment destination for Chinese companies in the selected countries.

According to Eurostat's 'Demography Report 2010', Poland and Romania are the biggest markets in terms of the size of population (38,1 and

21,5 million), while the others are medium-sized (10,6 million in Czech Republic, 10 million in Hungary and 7,6 million people in Bulgaria), although from Chinese point of view all of them are considered rather small. Czech Republic, Poland and Hungary are relatively affluent markets as well: based on IMF WEO database, GDP per capita is highest in Czech Republic (18600 USD in 2012) somewhat lower in Poland (12700 USD in 2012) and Hungary (12600 USD in 2012) but considerably lower in Romania (7900 USD in 2012) and Bulgaria (7000 USD in 2012).

In all of the above-mentioned countries there are investment incentives for potential foreign investors, for example tax incentives and job creation grants or 'personalized' advantages. In Poland there are special economic zones as well, two of them dedicated to Chinese investors (Kielce, Koszalin), while in Hungary there is a possibility to receive a residence visa for a certain amount of investment (see the chapter below). Bulgaria provides full tax exemptions in areas with unemployment 35% above average. Besides national government's incentives for FDI, foreign investors can also use financial support coming from EU funds for increasing employment, which can amount even to 50% of total investment (McCaleb-Szunomár, unpublished manuscript).

**6. Conclusions and policy recommendations**

Chinese outward foreign direct investment has been on the rise, and the increase has accelerated in recent years: China seems to assume the role of one of the world's largest investors – reflecting its global economic power.

The Chinese government launched the *go global* policy in 2000, to transform Chinese companies into globally competitive firms through outward foreign direct investments. In line with this strategy, and particularly after 2008–since the crisis raised the number of financially distressed firms and thus created additional overseas investment possibilities for China– Chinese OFDI steadily increased. Another important factor encouraging Chinese OFDI is the accumulation of foreign exchange reserves: next to safe but low-yielding assets, the Chinese government is looking to diversify its investment portfolio and seeks more profitable possibilities.

While Chinese OFDI in emerging or developing countries is characterized more by resource-seeking, Chinese companies in the developed world are focusing typically on buying themselves into global brands or distribution channels, getting acquainted with local management skills and technology, so-called strategic asset seeking. Regarding modes of entry, investments shifted from greenfield investments to mergers and acquisitions currently representing around two-thirds of all Chinese OFDI in value. This shift is driven by the financial crisis, however it also seems to be a new trend of Chinese FDI to the developed world, while greenfield investment remains significant in the developing world. Although host countries would prefer the latter since it usually creates jobs, one cannot deny the positive effects of Chinese M&As either. As several of these mergers and acquisitions took place during or after the crisis to save dysfunctional and unprofitable companies from bankruptcy, they often saved already existing jobs (or created new ones, too).

China's OFDI has also become more diversified in the past years: from mining and manufacturing it turned towards high technology, infrastructure and heavy industry, and lately to the tertiary sector: business services and finance but also health care, media and entertainment. Asia continues to be the largest recipient, accounting for nearly three-quarters of total Chinese OFDI, followed by the EU, Australia, the US, Russia and Japan. Numbers might be misleading though due to round-tripping (the investment is placed in offshore financial centers only to flow it back in the form of inward FDI to China to benefit from fiscal incentives designed for foreign investors). According to project-level analysis, 60 percent of Chinese ODI is aimed at developed economies like Australia, Hong Kong, the United States, Germany, and Canada.

As for Chinese OFDI to the European Union, the increase was far above the growth rate of Chinese OFDI globally. A combined analysis of both Chinese and European data sources suggests that although Chinese investment in Europe is still insignificant compared to other investors, but it is rapidly intensifying. The main reason for that is investing in Europe is perfectly in line with long-term Chinese goals of gaining access to a large consumer market, high value-added and green technologies as the next phase of their development. Regarding investment amount in sectoral distribution chemicals, plastics and rubber, utility and sanitary services, automotive original equipment manufacturers (OEM) and components rank highest. As for geographical distribution, Chinese investment is very unevenly distributed, the top recipients of Chinese FDI being traditionally France, the United Kingdom and Germany.

The Eurozone crisis attracted Chinese investors due to falling prices. However, China is reluctant to play a decisive role in bailing out European countries struggling with sovereign debt crisis. Chinese bond purchases were lagging far behind levels that Europeans hoped for. Since most European companies, financial institutions and countries urgently need capital, it is of crucial importance to attract investors from a country where foreign exchange reserves amount to almost four trillion dollars.

So European decision-makers on the one hand must address negative public perception of Chinese investments where necessary. In order to achieve that, the EU needs better FDI statistics, focusing especially on the positive impact of Chinese OFDI (e.g. preserving jobs and creating new ones). On the other hand, they must make sure Chinese investors are ready to adapt to local circumstances by clearing requirements for foreign investors and by creating an EU-level common investment framework. Chinese firms are mostly struggling with regulatory inconsistency and uncertainty across EU-member states. Bilateral investment treaties create a large room for protectionist moves which is far from the common European interest. Therefore, an EU-wide strategy should be elaborated (and in the post-Lisbon treaty legal Framework, the EU is legally entitled to realize that) towards Chinese (and other foreign) investors with uniform requirements. Furthermore, the EU could incorporate inward FDI into its own development plans, and make recommendations regarding the types of investment and industry to be promoted and prioritized.

As we mentioned above, Chinese investors prefer „old European" investment destinations not only because of market size but also because of well-established, sound economic relations with these countries. Therefore, investment promotion agencies (IPAs) should work on investment facilitation, such as clear administrative requirements, facilitation of visa and work permit processes, etc. all over Europe, giving a helping hand to Chinese investors unfamiliar with local circumstances. *Clegg* even suggests Chinese firms may need "mentoring" to explore European markets (Clegg, 2013). However, IPAs often compete against each other indirectly with different strategies, different opportunities and approaches: some of them have a distinct approach on emerging countries, some even have a China-specific strategy with Chinese-language website or local offices in China. It is worth examining the possibility of regulating national IPAs on the EU-level in order to avoid counterproductive effects.

Chinese investment in Central and Eastern Europe constitutes a relatively small share in China's total FDI in Europe and is quite a new phenomenon. Nevertheless, Chinese FDI in the region is on the rise and expected to increase due to recent political developments between China and certain countries of the region, especially Hungary and Poland.

CEE countries might attract more FDI from China with new fiscal (e.g. tax exemptions) and non-fiscal incentives. However, most of the CEE governments lack a unified strategy towards Chinese investors. Hungary is one of the few exceptions where in the spring of 2012 the government launched a new economic policy with special emphasis on the so-called "Eastern opening". This strategy puts emphasis on developing trade (and technology) relations with China and other emerging countries, too. The success of the strategy translates into an increasing amount of Chinese FDI in Hungary, which is by far the highest in the region.

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