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BILATERAL FLOWS OF FOREIGN DIRECT INVESTMENT BETWEEN CHINA AND EUROPEAN UNION

Abstract: The attention of the author was focused on capital flows in the form of foreign direct investment (FDI) between China and European Union countries. The author analysed the volume of bilateral flows of foreign direct investment and searched for the answer about its determinants. The main aim of the paper was an analysis of Chinese outward foreign direct investment as a new, but gaining significance, phenomenon. Important part of the paper was a recommendation of future development of FDI flows between the countries.

Key words: foreign direct investment, China, European Union.

1. Introduction

Last twenty years were a period of unprecedented development of foreign direct investment flows in the world. Both firms from developed and developing countries increased their activities in this field. But the pace of rise was significantly faster in the latter group of economies. The most distinguished examples have been large fast developing countries like Brazil, Russian Federation, India and China, called the BRIC countries. Among them China has played a major role and the dynamics of global changes requires new look at this country. China has also become a significant source of FDI as Chinese companies search for new production opportunities abroad.[1]

The change of China's position was confronted in this paper with the development of FDI flowing out and into European Union (EU). One of the research questions pertains the issue of exploiting investment opportunities by the both partners. China as a robustly growing market and a favourable location for many business activities should attract the bulk of FDI from European Union. On the other hand, Chinese companies should not be indifferent of the size of a Common Market or advanced technologies developed by EU companies.

[1] A. Klimek, Multinational enterprises from emerging economies. Seeking new theoretical framework, *Asian Studies* 2010 [forthcoming].

The paper is organized as follows. Section 2 presents the development of policy towards foreign investment in China. In the third section the centre issue is development of Chinese regulation referring to the issue of outward FDI. Section four delivers numerical analysis of FDI development between China and European Union.

2. Evolution of regulations pertaining to foreign direct investment in China

Most researchers recognise a successful story of foreign investment in China. We could notice very high rate of growth of the inflows of FDI to this country, especially after 1990. The inflows of FDI predominantly have come from other Asian countries, firms of which rather focus on serving Chinese markets. It is opposite to the investment projects originated in United States and Europe, which are rather of export-oriented type.

The inflow of foreign direct investment to China is one of the important factors of development of this country. According to econometric analyses inward FDI in China positively contributed to the growth of *per capita* income, exports and productivity.[2] This was especially the case for coastal areas where great part of foreign investment has been located. Important factor of promoting FDI in this country was creating a favourable conditions by the time and regions.[3] But in some cases the extensive involvement of the government was not conducted in line with foreign investors' expectations.

We need to highlight that Chinese authorities, when giving approval for foreign direct investment in this country, mostly focused on receiving new technology and resources, which could boost the country's modernisation.[4] We can draw here a further conclusion that FDI flowing to the country positively influenced Chinese companies in their foreign operations (e.g. "spill-over effect".[5])

3. Government promotion of Chinese firms' global expansion

China is no longer only the beneficiary of foreign direct investment flowing to the economy. The aim of the Chinese government is not only the increase of investment and production in home economy, but also support for selected firms in their foreign

[2] E.M. Graham, E. Wada, *Foreign Direct Investment in China: Effects on Growth and Economic Performance,* Working Paper 01-03, Institute for International Economics, Washington, DC, 2002, p. 10.

[3] L.F.Y. Ng, C. Tuan, Building a favourable investment environment: evidence for the facilitation of FDI in China, *The World Economy* 2002, Vol. 25, No. 8, pp. 1095-1114.

[4] E.M. Graham, E. Wada, *op. cit*., p. 6.

[5] G.B. Navaretti, A.J. Vanables, *Multinational Firms in the World Economy*, Princeton University Press, Princeton and Oxford 2004, p. 17.

expansion. But China is not the sole example of such support. Other emerging countries, like Brazil or Russian Federation, also create favourable conditions for foreign expansion of firms from their countries.

During last years we could witness a policy shift in China towards promoting foreign activities in various manners. Introduction of incentives for outward FDI can be divided into three phases.[6]

Phase 1 – 1984-1990 – "Fresh flowers" or "Poisonous Grass". The period took place during the time when the Chinese economy was still relatively fragile and it was tricky to imagine companies from this country going abroad. Not only macroeconomic weakness was a sobering fact that days, but also lack of any foreign experience of Chinese companies were not favourable conditions.[7] The phase was a result of the "Open Door" policy implemented in the end of 1970s. China in that period mostly focused on the inward investment and was not convinced about the necessity of going abroad. Very strict regulations of outward FDI and foreign exchange restrictions caused that the number of Chinese companies investing abroad remained at a moderately low level in the 1980s.

Phase 2 – 1991-2000 – "Finding the Stepping Stone". In this period Chinese government permitted some companies to compete on market conditions. The firms were somehow sovereign in their decisions and could start their global operations. But the small private owned companies were in the shadow of large state-owned conglomerates. The latter companies have been heavily supported by the state in their global activity, especially in resources industries. The state-owned enterprises were supposed to acquire foreign technology, markets and resources. Companies starting overseas activities still had to obtain many permissions from authorities. Every investment project abroad made by a state-owned company and involving assets of over 1 million USD should be approved by National Planning Commission.[8]

Phase 3 – 2001 – present – "Going abroad". The last phase includes removing many bureaucratic barriers in flowing capital abroad. Moreover, higher authorities encourage companies from China to go abroad. The most important fact was reduction of direct control and command over the economy. The government started focusing rather on wider liberal opening.[9] But it is difficult to consider that Chinese companies can operate abroad without much regulation and numerous investment projects are in line with government plans.

Chinese enterprises can be also financially supported by the government. It can take a form of avoiding double taxation of corporate income, credit support (no

[6] Y. Luo, Q. Xue, B. Han, How emerging market governments promote outward FDI: Experience from China, *Journal of World Business* 2010, Vol. 45, pp. 68-79.

[7] P.J. Buckley *et al*., The determinants of Chinese outward foreign direct investment, *Journal of International Business Studies* 2007, Vol. 38, No. 4, pp. 499-518.

[8] Y. Luo, Q. Xue, B. Han, *op. cit*., p. 72.

[9] D. Bach, A.L. Newman, S. Weber, The international implications of China's fledging regulatory state: From product maker to rule maker, *New Political Economy* 2006, Vol. 11, No. 4, pp. 499-518.

interest) or subsidies for companies investing abroad. China has also increased the limit of foreign currency spent on foreign investment and plans to remove the limits in the future.[10]

During the three phases we can observe significant change in the government policy towards supporting foreign direct investment projects. It is particularly evident in industries providing natural resources or technology. The support delivered by the government raises the questions about the transparency and intentions of prospective investors.[11] It is worth underlining that most of outward FDI by Chinese companies take a form of acquisition rather than greenfield projects. It means that Chinese enterprises prefer to purchase tangible and intangible resources abroad than to develop them in the home economy.

Latest research contributions emphasize that the institutional incentives are not crucial when deciding about foreign engagement by Chinese companies. The companies make their individual strategic choices and are very rational when investing overseas.[12]

Considering Chinese capital expansion, we have to highlight investments made directly by the authorities using China Investment Corporation. This is a sovereign wealth fund managing vast capital devoted to investments in promising companies in China and abroad. The size of the capital is estimated to be 200 billion USD and its source are country's foreign exchange reserves, accounted for over 2 trillion USD.[13] The activity of the institution was on the headlines when acquired significant stake in Morgan Stanley, Wall Street investment bank.

4. Numerical analysis

In order to identify the trends in flows of long-term capital in form of FDI between China and European Union the statistical comparison was employed. For this purpose two sources of data were utilized: Eurostat, which measures the volume of FDI flowing out of EU economies, and Ministry of Commerce of the People's Republic of China (MOFCOM) delivering data on Chinese investment abroad.

Three largest EU economies are only significant investors in China: France, Germany and United Kingdom (Table 1). These countries are responsible for over half of the total EU investment in China. Due to the economic crises escalation in 2008 it is more reliable to analyse the trend for the period of time between 2003 and 2007. In 2008 significant decrease in FDI from EU to China was noticed, even if Chinese economy was one of few dynamically developing. The situation confirms

[10] Y. Luo, Q. Xue, B. Han, *op. cit*., p. 76.

[11] A. Antkiewicz, J. Whalley, *Recent Chinese Buyout Activity and Implications for Global Architecture*, Working Paper 12072, National Bureau of Economic Research, Cambridge, MA, 2006, p. 2.

[12] H. Rui, G.S. Yip, Foreign acquisitions by Chinese firms: A strategic intent perspective, *Journal of World Business* 2008, Vol. 43, pp. 213-226.

[13] SWF Institute, www.swfinstitute.org [accessed: 20-04-2010].

assumption that greater impact on the level of FDI is caused by the situation in home economy of MNC.

Table 1. FDI of European Union countries in China (million EUR)

Country \ Time	2003	2004	2005	2006	2007	2008
Belgium	43	–303	38	68	387	–342
Bulgaria	0	0	0	0	0	0
Czech Republic	0	0	0	0	–1	–5
Denmark	13	0	235	314	686	–135
Germany	1558	1199	2489	2442	1373	836
Estonia	0	0	0	0	1	0
Ireland	0	–1	3	24	0	61
Greece	0	0	2	0	0	0
Spain	40	76	123	197	186	189
France	285	397	678	504	1069	1099
Italy	42	103	230	204	388	253
Cyprus	0	0	0	4	0	10
Latvia	0	0	0	0	0	0
Lithuania	0	0	0	0	0	0
Luxembourg	–5	56	56	45	69	99
Hungary	1	0	2	4	–17	–1
Malta	0	0	0	0	0	0
Netherlands	–130	220	522	337	441	860
Austria	17	38	112	189	182	24
Poland	0	2	7	9	8	1
Portugal	0	1	2	2	4	0
Romania	0	0	0	0	0	0
Slovenia	0	0	3	4	3	1
Slovakia	0	0	0	0	0	0
Finland	315	450	90	39	572	–53
Sweden	6	3	210	174	128	107
United Kingdom	447	794	875	549	1663	1301
European Union	0	3868	6137	6693	6585	4734

Source: own calculation based on Eurostat data.

In 2008 Chinese investment in European Union dropped significantly comparing to 2007, but still was on much higher level comparing to the period 2003-2006

(Table 2). The data confirm that inflows of Chinese capital have positive trend. Nevertheless, the total value of Chinese investment in EU was about 10 times less than EU investment in China. Main location of Chinese investment in Europe were Germany, the Netherlands and United Kingdom.

Table 2. Chinese FDI in European Union countries (million EUR)

Country \ Time	2003	2004	2005	2006	2007	2008
Austria	0.32	–	–	0.03	0.06	–
Belgium	0.24	0.04	0.00	0.10	3.59	–
Bulgaria	0.28	0.28	1.38	–	–	–
Cyprus	–	–	–	–	–	–
Czech Republic	–	0.37	–	7.25	3.63	8.74
Denmark	59.47	–6.26	8.69	–46.95	0.20	0.91
Estonia	–	–	–	–	–	–
Finland	–	–	–	–	0.01	1.82
France	0.36	8.30	4.90	4.46	7.03	21.21
Germany	20.17	22.14	103.64	61.15	174.46	125.27
Greece	–	0.16	–	–	0.02	0.08
Hungary	0.95	0.08	0.52	0.29	6.31	1.47
Ireland	0.11	–	–	20.16	0.15	28.91
Italy	0.23	2.50	6.01	6.08	5.92	3.42
Latvia	1.26	–	–	–	–1.27	–
Lithuania	–	–	–	–	0.00	–
Luxembourg	–	–	–	–	3.06	28.77
Malta	–	0.30	–	0.08	–0.07	0.32
Netherlands	3.60	1.54	3.09	4.23	78.03	62.82
Poland	1.25	0.08	0.10	–	8.59	7.31
Portugal	–	–	–	–	–	–
Romania	0.49	2.16	2.31	7.68	4.97	8.18
Slovakia	–	–	–	–	–	–
Slovenia	–	–	–	–	–	–
Spain	–	1.37	1.18	5.82	4.45	0.79
Sweden	0.14	2.13	0.81	4.22	49.75	7.28
United Kingdom	1.70	23.66	19.95	27.99	414.14	11.41
European Union	90.58	58.83	152.58	102.60	763.03	318.70

Source: own calculation based on MOFCOM data.

Besides comparing absolute values of FDI it is important to measure the ratio of bilateral investment in each country/group of countries (Table 3). The flow of European Union FDI to China is not more than 1% of total outward FDI of EU economies. China is still a marginal partner in the activities. But it is interesting to look at whole Asia, where the ratio is relatively high (7.9% in 2008).The largest amount of FDI is flowing between EU countries.

Table 3. Composition of European Union outward FDI (%)

GEO \ Time	2003	2004	2005	2006	2007	2008
Asia	0.0	9.6	6.4	3.2	4.4	7.9
China	0.0	1.0	0.9	0.8	0.5	0.5
Africa	0.0	3.8	2.4	1.3	1.4	2.1
Latin America	0.0	5.3	2.0	1.9	2.0	1.6
North America	0.0	0.9	0.2	0.5	0.4	1.7
Oceania	0.0	0.5	NA	0.8	0.7	1.6
EU-27	0.0	61.5	64.2	64.6	57.1	60.8
Total	0.0	100.0	100.0	100.0	100.0	100.0

Source: own calculation based on Eurostat data.

It confirms two theses. First of all, the business relations between EU and China are still on a very low level. European companies do not treat China as a very important market. Additionally, the European investment in China still focus on abundant labour force, rather than the thriving market. Second conclusion coming out of the data is that similar level of EU investments is also in North America, another large market. It confirms that most of investment projects are conducted in the same region.

Table 4. Composition of Chinese outward FDI (%)

GEO \ Time	2003	2004	2005	2006	2007	2008
Asia	52.7	54.8	36.6	43.5	62.6	77.9
Africa	2.6	5.8	3.2	2.9	5.9	9.8
Latin America	36.4	32.1	52.7	48.0	18.5	6.6
North America	2.0	2.3	2.6	1.5	4.2	0.7
Oceania	1.2	2.2	1.7	0.7	2.9	3.5
European Union	3.9	1.3	1.5	0.7	3.9	0.8
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: own calculation based on MOFCOM data.

When we observe the data representing share of FDI in the European Union in a total value of Chinese outflows, we can draw similar conclusions as it was in case of China as a location for European investment (Table 4). In most of analysed years the ratio was around 1%. But we could also notice higher values (in the years 2003 and 2007). It means that Chinese companies are slightly more active in Europe than vice versa. Drawing further conclusion we can say that Chinese firms see more chances in Europe than European companies in that country.

The reason for low level of Chinese investments is also the lack of knowledge about European business environment among Chinese companies and their inability to compete with local firms.[14] Chinese firms prefer to invest in countries with abundant natural resources and European Union is rather an importer of the type of commodities. Enlarged European Union as a unique integration area should attract more investment from China as the effects of integration on FDI were proved to be significant.[15]

5. Summary

China has become an important player in the global economy in various aspects. The economic development of the country has been accompanied by changes in policy towards outward foreign direct investment. The policy can be described as government promotion of overseas activities. However, the support delivered by the authorities raises questions about the transparency and sovereignty of foreign operations.

The data representing Chinese investment though may be slightly misleading due to the fact that a significant portion of capital flows through Hong Kong ("round-tripped"). This situation both concerns the inflows to China and outflows of capital from this country. The figures may be more accurate in the future when much of the regulations and limits of capital flows will be removed.

Resuming, we can say that FDI intensity between the analysed countries/group of countries is still a quite neglected factor. Adding to consideration political relations between EU and China, it is very unlikely that the values will improve in coming years.

[14] B. Beger, A. Berkofsky, *Chinese Outward Investment – Agencies, Motives and Decision-Making*, CASCC Briefing Paper, Centro di Alti Studi sulla Cina Contemporanea, 2009, p. 15.

[15] J. Clegg, S. Scott-Green, "The determinants of new FDI capital flows into the EC: A statistical comparison of the USA and Japan", *Journal of Common Market Studies* 1999, Vol. 37, No. 4, pp. 597-616.

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WZAJEMNE PRZEPŁYWY BEZPOŚREDNICH INWESTYCJI ZAGRANICZNYCH MIĘDZY CHINAMI I UNIĄ EUROPEJSKĄ

Streszczenie: W centrum uwagi autora tego artykułu znalazły się powiązania kapitałowe w formie bezpośrednich inwestycji zagranicznych (BIZ) między Chinami a krajami Unii Europejskiej. Autor poszukiwał odpowiedzi na pytanie o rozmiary wzajemnych bezpośrednich inwestycji zagranicznych i ich determinanty. Nakreślone zostały również perspektywy przyszłych przepływów BIZ oraz warunki ich rozwoju. Główny nacisk w tym artykule został położony na analizę chińskich inwestycji za granicą, jako zjawiska nowego, lecz zyskującego coraz większe znaczenie.