

Chinese Direct Investment in the Baltic Sea Region

Some Recommendations for Policymakers

By Jean-Marc F. Blanchard

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Summary

Although Chinese outward foreign direct investment (OFDI) has been increasing dramatically globally since 2005, it only started to increase significantly in the Baltic Sea Region (BSR) after the outbreak of the 2008 Great Financial Crisis. Chinese OFDI (COFDI) in the BSR has been heavily concentrated in Germany and Russia with a very strong focus on the energy and technology sectors. This mirrors what we have seen elsewhere: Chinese companies have been investing abroad to obtain natural resources, intellectual property and process knowledge, and leading brands in order to improve their competitive position at home, to facilitate greater sales abroad, and to help China satiate its economic development and national security objectives. Growing COFDI raises a number of potential political and economic consequences that warrant thoughtful consideration by policymakers, especially at a time when many are excited about the potential investment and other implications of China's eye-catching Belt and Road Initiative (BRI). This report gives background on COFDI and COFDI in the BSR, discusses some of the concerns associated with COFDI, and offers a number of policy recommendations.

Keywords

China, Baltic Sea Region, Chinese outward foreign direct investment, Belt and Road Initiative, Germany, Russia, investment promotion

Disclaimer: The views expressed in this report are those of the author(s) and do not necessarily represent the views of the Centrum Balticum Foundation, and thus, the Centrum Balticum Foundation does not bear any responsibility for the opinions expressed in the report.

¹ The author would like to thank Courtland Johnson for his excellent research assistance.

1. Introduction

2016 was a heady year for Chinese outward foreign direct investment (FDI). That year, annual Chinese outward FDI (OFDI) flows hit an all-time high reaching \$183 billion and the largest ever Chinese OFDI (COFDI) transaction (China National Chemical Corp.'s \$43 billion acquisition of Swiss firm Syngenta) took place. As far as COFDI and the Baltic Sea Region (BSR) is concerned, 2016 was an impressive year, too, with a number of major deals transpiring. These include Midea's purchase of Germany's Kuka for more than \$4.5 billion, Beijing Enterprises's approximately \$1.6 billion investment in Germany's EEW Energy, and Tencent's \$8.6 billion investment in Finland's Supercell. Many BSR capitals are pondering how they might snare their piece of the COFDI pie while others are wondering what are the political and economic consequences of increased COFDI. We certainly see the latter in Germany where anxieties grew after Chinese firms took (or attempted to take) stakes in high profile firms like Putzmeister, Kuka, and Aixtron.

While analyses of COFDI, its political and economic drivers, and its implications for the People's Republic of China (PRC/China) and host countries are voluminous and growing, the publicly available literature on COFDI in the BSR or individual BSR countries is quite scant. This has something to do with its newness as well as the low amounts of COFDI in many BSR countries. It also may have something to do with the paucity of good data, an issue addressed in this report's policy recommendations below, which hinders more rigorous analysis. With respect to the studies that exist, despite their usefulness, they often are outdated or use problematic data, cover all sources of FDI in the BSR rather than just COFDI, or fail to put COFDI in context relative to larger trends. For example, regarding the last point, there seems to be a presumption that just because a country has a firm with technology that Chinese companies would have an interest in investing in it without recognizing that host country market size, the PRC's industrial policy priorities, and "agglomeration effects" also shape the likelihood and nature of COFDI.

The policy relevance of studying COFDI in the BSR is quite clear. First, BSR governments, especially their investment promotion agencies, are attentive to COFDI. Furthermore, given the strong interest of Chinese firms in BSR intellectual property (IP)/technology, brands, and infrastructure, among other things, COFDI raises national security, economic independence, and social issues that warrant special consideration beyond the obvious fact that more COFDI raises questions that were not relevant when it was low. Aside from this, China is the world's second largest economic actor, a major global investor (albeit, to be discussed, perhaps not as aggressively as before) at a time when alternative sources of capital like the United States (US) and international capital markets seem less promising, and China's eye-catching Belt and Road Initiative (BRI), of which COFDI is a core component, hints at big capital flows to the region.

Policy recommendations: Below, this report details five policy recommendations relating to COFDI in the BSR. To preview, it calls for a push to develop better data. It also suggests that BSR countries consider undertaking collaborative investment promotion. Furthermore, recommends that BSR countries create or enhance investment review processes for COFDI. Beyond this, it urges BSR countries to be cautious about offering economic incentives to attract COFDI. Finally, it advises BSR countries to be on the alert for "divide and conquer" tactics.

This report has seven parts. The second (next) part provides a primer on COFDI, offering, for instance, statistics on annual flows and COFDI geographic and sectoral destinations. The third supplies similar data, but focuses on COFDI in the BSR. It further considers what the portrait looks like if we exclude COFDI in Germany and Russia, the BSR's economic heavyweights. The fourth highlights diverse matters raised by COFDI including national security and employment issues. The fifth examines a number of major COFDI transactions in the BSR states. The sixth contemplates China's BRI and the BSR, reporting on some of the expectations associated with China's massive globe spanning scheme and some of the serious challenges facing it. The last part offers some summary, advances several policy recommendations, and gives some closing remarks.

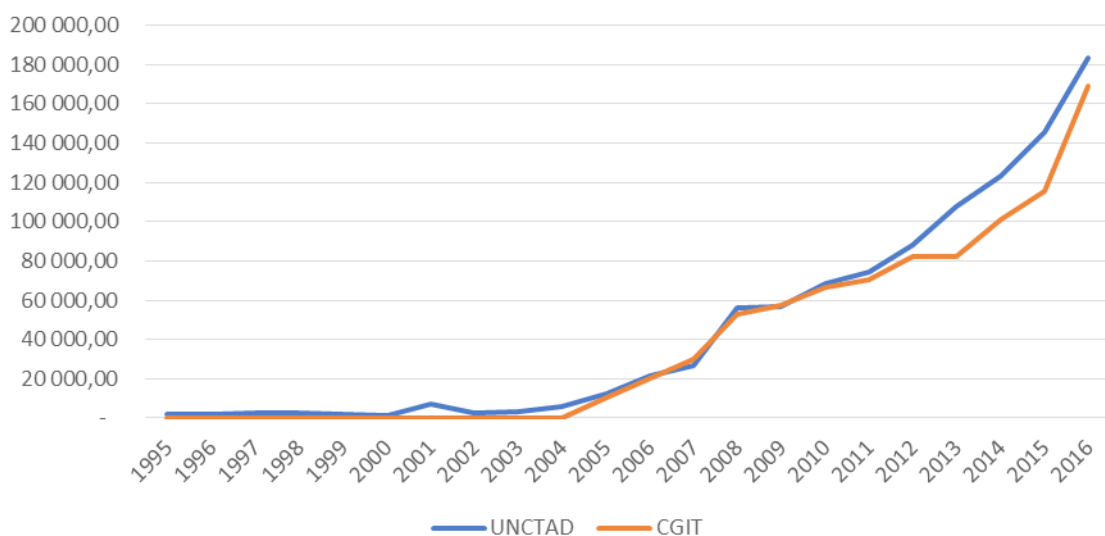
2. A Primer on COFDI

History: COFDI was insignificant in the 1970s and 1980s due to China's stress on inward FDI (IFDI) as a mechanism for achieving its economic development goals, the inexperience and limited capabilities of Chinese firms, and China's lack of financial resources such as foreign exchange that could support overseas investment. In the 1990s, COFDI, while low in absolute terms, took a noticeable upward turn as some of the aforementioned constraints lessened and China became interested in using COFDI as a tool to acquire IP and process knowledge, improve its access to resources (it is important to point out that China became a net oil importer for the first time in 1993), and achieve political objectives such as more tightly linking Hong Kong, which reverted to the PRC in 1997, with the mainland.

Beijing also began to view COFDI as a way to boost exports. In the 2000s, COFDI reached new heights as a result of a confluence of factors, many relating to China's admission to the World Trade Organization (WTO). China's WTO accession intensified foreign pressure on Chinese firms giving them reason to go abroad to enhance their competitive position as well as led China to accumulate massive amounts of foreign currency. Beyond this, China's role as the world's factory (partly related to its WTO membership), rising living standards, the depletion of domestic resources, security concerns, and other drivers added impetus to Chinese companies' need to venture overseas. This decade, Chinese firms have been leveraging abundant government financial support, greater abilities and experience, and China's good diplomatic relations with other countries to invest abroad. Also supporting greater COFDI has been *inter alia* the quest for cutting-edge technologies, leading global brands, and access to new or better markets. As the data below show, in this decade, COFDI has reached a new level in terms of annual flows. Moreover, OFDI from China is becoming more noteworthy relative to other major outward investing nations.

General data: Chart I below, which is based on data from the UNCTAD *World Investment Report* and the American Enterprise Institute and the Heritage Foundation "China Global Investment Tracker" (hereinafter "CGIT"), illustrates the tremendous growth in annual COFDI flows between 1995 and 2016. As far as COFDI stocks are concerned, there has been a dramatic increase in tandem with the significant annual growth in COFDI. According to UNCTAD, whereas COFDI stocks were only \$900 million (!) in 1985, they hit almost \$4.5 billion in 1990, reached \$27.76 billion in 2000, more than doubled to \$57.20 billion by 2005, exploded to \$317.21 billion by 2010, and exceed \$1.01 trillion as of 2015.

Chart I - Annual COFDI Flows, 1995 to 2016
(USD Millions)



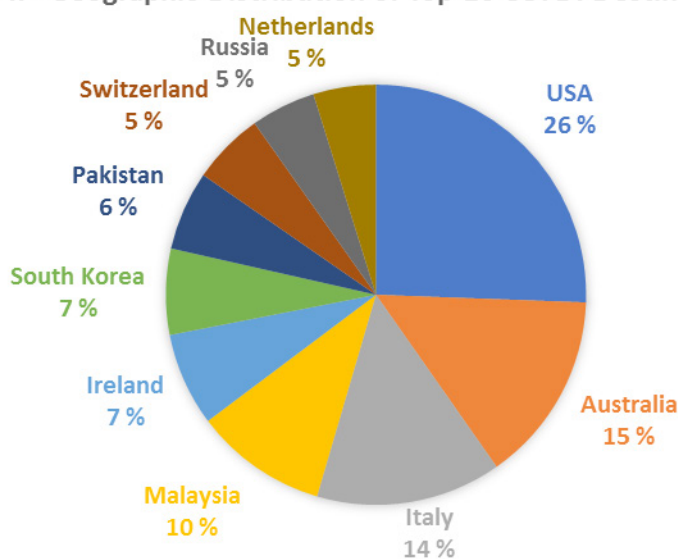
Source: UNCTAD *World Investment Report* and CGIT.

Geographic and Sectoral Destination Patterns: Until recently, it has been a common misperception that COFDI has been a developing world story as far as geographic destination was concerned. This was a function of poor COFDI statistics which did not accurately reveal the end locale of Chinese investment and the predominance of the image of China as a ravenous dragon exploiting the developing world in search of resources. The reality, though, is that the location of Chinese money has varied over the decades depending upon factors such as the PRC’s needs, the requirements and abilities of Chinese companies, and the situation in host countries. After China began its reform and opening in the late 1970s through the 1980s, most COFDI went to the Asia-Pacific Region (APR) and developed countries like Canada and the US.

The reasons for the former include greater familiarity with the APR and a desire to promote exports while the reasons for the latter include the search for resources. In the 1990s, COFDI flowed to Australia, North America, Peru, and Russia. This largely reflects China’s search for energy and minerals. In the 2000s, we witness continuing flows of COFDI to countries like Australia, Peru, South Africa, the United Kingdom (UK), and US. As before, this reflects China’s quest for natural resources, but also investments in brands, technology, and post 2008 Great Financial Crisis (GFC) bargain hunting. This decade, Chinese players have been pouring money into both the developed and developing world countries such as Australia, Brazil, Indonesia, Peru, and the US in order to garner resources, brands, and technology.

Using the aforementioned CGIT, Chart II illustrates the geographic distribution of COFDI in 2015, focusing on the top 10 COFDI destinations, which account for more than 50 percent of total annual COFDI that year. Generally speaking, CGIT data is superior for analyzing COFDI’s geographic distribution because, unlike Chinese government data (prepared by China’s National Bureau of Statistics), it accounts for the fact that money going to tax havens frequently passes on to other destinations.

Chart II - Geographic Distribution of Top 10 COFDI Destinations, 2015



Source: Author’s compilation using CGIT.

COFDI Drivers: There are a myriad of COFDI drivers at the global, regional, national, sectoral, and firm-levels, as with OFDI from any country. Global and regional factors entail global and regional economic conditions, economic development ideologies, and regional economic institutions such as free trade agreements. Examples of national variables are the savings rate, interest rates, foreign currency reserves, the natural resource situation, and national consumption patterns. Sectoral drivers include agglomeration effects, competition structures (e.g., monopoly versus oligopoly), and a high-import/product input ratio. Firm-level factors entail overseas experience, cost cutting needs, internalization opportunities, host country investment incentives, and home country policy. It is important to note that these factors do not necessarily all matter equally, matter at all times, or matter the same for private companies as for state-owned enterprises (SOEs) and that unpacking the most powerful factors at a particular

time in a specific sector is a challenge for academics and investment promotion officers alike. This said, looking at annual flows data and geographic and sectoral COFDI distribution patterns we see that Chinese companies often have gone abroad to obtain assets/endowments they do not possess in adequate quantity, quality, or both, though the end motivation is not necessarily just to bolster profits.

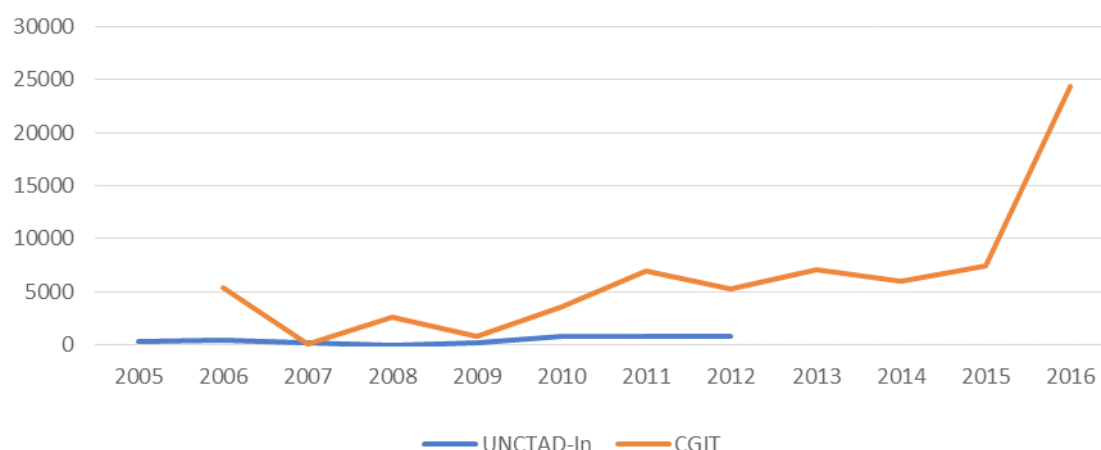
Recent issues: One important recent development relating to COFDI is Beijing's much more restrictive attitude towards it. The origins of it can be traced back to China's plunging foreign currency reserves that started in 2014. Whatever the causes of this massive decline in reserves, Beijing pointed a finger at supposedly "irrational" and potentially illegal (in some cases) outward investment activities, with "irrational" meaning transactions were done at unreasonable prices, with excessive leverage, or in sectors far afield of the acquirer's core area of expertise. Since that time, Beijing has reined in OFDI, as vividly reflected by the latest COFDI statistics, while some of more aggressive Chinese acquirers have restrained themselves. Moreover, China reportedly has instituted a reporting and penalty system that likely will restrain COFDI even if no penalties are imposed. Of note, the biggest impact of the "new order" as far as COFDI is concerned seems to have been on private firms. Given that they were the biggest outward investors in 2016 and are some of the most aggressive players in terms of seeking IP, brands, and markets and that SOEs are relatively staid and constrained in the assets they can buy as a result of suspicions about them and limits in the pool of assets that they are prone to buy (e.g., natural resources) then we are not likely to see COFDI reach heights like that in 2016. Still, there are many powerful forces that will encourage greater COFDI going forward.

3. Dissecting the Data on COFDI in the BSR

History: There is no authoritative history of COFDI in the BSR, but one can paint a general portrait from data on annual flows and geographic and sectoral distribution of COFDI in the BSR (done below) as well as some studies of COFDI in the BSR and individual BSR countries. While there were some large investments in Russia and Norway prior to the 2008 GFC, the BSR essentially was off the radar of Chinese firms until 2010 when Geely bought Sweden's Volvo. Thereafter, while the annual flows did not show year-over-year (YOY) increases, aggregate COFDI in the BSR continue to grow from 2010 to 2016 with Chinese money entering Germany and Russia regularly. Finland, Sweden, and Norway also attracted funds, though investments were highly episodic. There has been no YOY growth pattern to the sectoral distribution of COFDI other than the fact it has been consistently flowing into energy and technology. Irrespective of the above, there were at least several hundred small-scale investments by Chinese firms of various sizes in the BSR prior to 2008 in countries like Denmark, Germany, Norway, Poland, and Sweden, mostly in the trade sector. Excluding very small retail/service businesses, it appears that Chinese companies invested to bolster knowledge of local tastes/product requirements, improve connections with customers, expand their access to the region, obtain brands, IP, and human talent, and leverage their low-cost production structures. In the case of Russia, non-real estate investments prior to 2008 were largely in resources, though there were investments in areas like auto manufacturing and telecommunications, too.

COFDI Flows: Identifying annual COFDI flows to the BSR is no easy task. Potential sources like UNCTAD, the Organization of Economic Cooperation and Development (OECD), China's Ministry of Commerce (MOFCOM), the CGIT, and agencies in individual BSR countries differ in their definitions of OFDI (e.g., net versus gross investment), the kind of data they gather (e.g., MOFCOM does not include retained earnings or information on non-reported transactions), and the currency units (USD, Euros, or local currency) used to gauge COFDI. Moreover, for many of the sources, data is not available for a range of recent years. Given these issues, Chart III shows COFDI flows to the BSR using both "UNCTAD-In" and CGIT data for 2005-2016.

**Chart III - Annual COFDI Flows to the BSR, 2005-2016
(USD Millions)**



Source: UNCTAD-In and CGIT.

UNCTAD-In data is not particularly informative because it ends in 2012. For its part, CGIT data highlights that COFDI in the BSR soared after the 2008 GFC. To some extent this is attributable to bargain hunting, but many Chinese investments after 2008 did not involve the purchase of assets selling at low prices so other factors such as those mentioned above in the review of general COFDI drivers and below in the discussion about the drivers of COFDI in the BSR probably were more powerful drivers of COFDI's surge.

Geographic distribution: While COFDI started flowing into the BSR before the 2008 CFC, it was not particularly noteworthy except for a series of large investments in Russia in 2006 by China Petroleum & Chemical Corporation (Sinopec) and China National Petroleum Corporation (CNPC) and a \$2.5 billion investment by SinoChem in Norway in 2008. Focusing on the period from 2010 through 2016, Table I shows that the Baltic and Nordic countries have not been very successful in attracting COFDI.

**Table I – The Geographic Distribution of COFDI in the BSR, 2010-2016
(USD millions)**

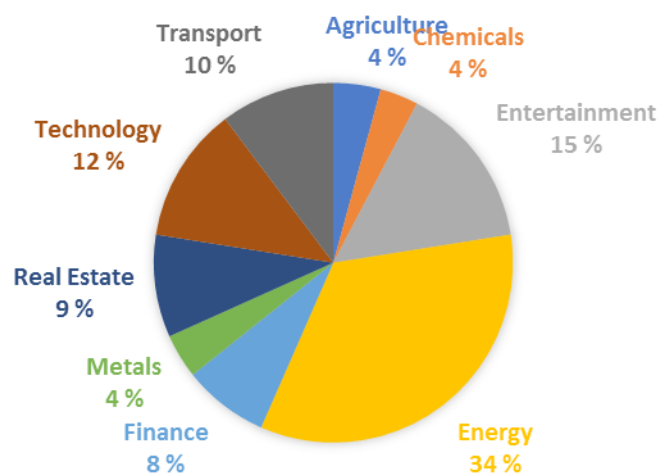
Country/Year	2010	2011	2012	2013	2014	2015	2016	Total (by country)
Denmark	0	0	0	0	0	0	0	0
Estonia	0	0	0	0	0	0	0	0
Finland	0	0	0	0	0	0	9,890	9,890
Latvia	0	0	0	0	0	0	0	0
Lithuania	0	0	0	0	0	0	0	0
Norway	2,010	0	0	0	640	0	720	3,370
Poland	0	0	100	0	200	0	140	440
Sweden	2,700	0	0	0	0	2,200	0	4,900
Germany	0	2,040	2,700	800	1,620	620	11,420	19,200
Russia	830	2,940	2,520	6,250	3,530	3,600	2,230	21,900
Total	3,530	6,990	5,320	7,050	5,990	6,420	24,400	59,700
Germany and Russia's share of Total	24%	71%	98%	100%	86%	70%	56%	69%

Source: Author's compilation using CGIT.

Germany and Russia have dominated as the BSR's major COFDI recipients. This is clearly shown in Table I where from 2011 through 2016 they always received more than 50 percent of COFDI flowing into the BSR. Indeed, in many years, these two economic giants' share of the total has exceeded 70 percent! The reasons for this dominance are not particularly puzzling. Germany has the brands, IP, and market size that Chinese companies covet. Russia has the energy and mineral resources that China wants, coupled with the fact that Sino-Russian relations have been particularly strong for a variety of reasons such as the existence of Western sanctions against Moscow that make it receptive to closer economic links with Beijing.

Sectoral distribution: To get at the contemporary sectoral distribution of COFDI, we can exploit statistics from the CGIT. Chart IV shows the division over the period 2010 to 2016, ignoring, relatively speaking, the rather inconsequential "Utilities" and "Other" sectoral categories in the CGIT.

Chart IV - COFDI's Sectoral Distribution in the BSR, 2010-2016
(excludes Utilities And Other)



Source: Author's compilation using CGIT data.

Not unexpectedly given the geographic distribution described above, we see a large concentration of COFDI in the BSR's energy, technology, and transport sectors, mainly reflecting diverse Chinese investments in the Russian oil and gas industry, Midea's purchase of Germany's Kuka, and Geely's acquisition of Volvo. Tencent's massive investment in Supercell explains the large percentage of COFDI that seems to be flowing to the BSR's entertainment sector. One might make a reasonable argument that such an investment really should be categorized as a technology investment in which case COFDI investment in the BSR essentially is going into two sectors, energy and technology.

Drivers: Geographic and sectoral distribution data indicate quite clearly that Chinese firms are investing in the BSR's assets to help address their shortcomings. They invest in Russian energy assets because China cannot generate enough energy to meet the gap between its production and consumption. They invest in German and Swedish automobile and industrial firms to gain world class brands, process knowledge, and technology that they do not possess. Still, the access of Chinese companies to preferential government financing probably has given some an advantage that they can exploit to invest in the BSR. In most cases, gaining access to BSR or the neighboring European markets does not seem to be a driving force behind the big deals, but perhaps this is because BSR or European trade barriers against Chinese goods are not a large issue or most BSR countries represent small markets. As for politics, good political relations between Russia and China probably have eased COFDI in the former, but Chinese entities likely would have pursued investments in Russian resources even if relations were lukewarm.

4. Political and Economic Issues Raised by COFDI

There is a slew of political issues surrounding COFDI, not all of which can be discussed here. One, of course, relates to national security. If a Chinese firm buys IP relating to the cloud, invests in critical infrastructure like nuclear power or ports, or becomes a joint venture partner in a factory near a military base then national security considerations come to the fore, especially if the investing company is an SOE or the host country has the potential to have hostile relations with China. This is not to say that such deals incontrovertibly present national security issues, that they are severe, or that they cannot be mitigated, but rather that there are genuine substantive issues that necessitate research and consideration. National security issues relating to national independence also might emerge if Chinese investors in the aggregate made such huge purchases that they began to dominate a country's economy or gain potential leverage over a host country's foreign policy decision making. Such issues likely will be concerns more for the smaller rather than the larger BSR economies, but still could be salient for the latter depending upon their economic situation. *Viz.*, the weaker they are, the more politically consequential a given quantity of COFDI might be.

When Chinese firms acquire leading brands or IP, then another issue that gains salience is the potential implications of such a deal for a host country's national economic competitiveness. When Chinese firms began to invest in "more advanced" firms, there was concern that they would strip out valuable assets, shutter the acquired company, and take the IP back to China with the host country having lost the asset and the jobs, taxes, and economic increment associated with it. Moreover, there were worries that the acquirer (and any others with whom it shared the technology) could use their new IP assets to compete against host country firms at home and in other markets, which, to be fair, is an issue in all acquisitions, not just *Chinese* ones. To date, fears of "asset stripping" seem to be overblown with Chinese firms generally preserving the operations and staff that they have gained through their investments. As for the issue of technology transfer, we unfortunately do not have data that would allow us to gauge how much technology Chinese investors are transferring back to China.

Aside from their effect on national economic competitiveness, the other economic benefits of COFDI are a big question. Regrettably, there are few studies of this topic. Needless to say, Chinese investors bring capital, but it is unclear if this capital is the same, better, or worse than other potential sources (assuming other sources are available) in terms of its effect on growth, employment, employment quality, technological development, tax generation, exports, and competition. While the deep pockets of SOEs or access some Chinese firms have to finance at home may make them stable sources of capital, SOEs often do not pay attention to standard business metrics like return on equity (ROE), investment (ROI), and assets (ROA). This suggests that they may not be the best at promoting competition and dynamism in host countries. As for technological advancement, while it is argued by some that Chinese firms are now leaders in innovation, it is not clear that they contribute to host country technology development when they invest in host country technology firms or establish research and development (R&D) centers. In any event, one recommendation below is for greater research on the economic implications of COFDI for BSR countries through a series of systematic, comparable, in-depth case studies.

Chinese firms have relatively poor track records in regards to their employment and environmental practices inside China. This is not a surprise, especially in the case of SOEs, because many of the internal and external checks and balances that encourage other kinds of firms to practice good corporate social responsibility (CSR) are missing. However, one would expect Chinese companies to act differently overseas because of the new context. This is borne out in some cases, but not in others like the developing world. As far as Europe is concerned, there are very few studies of the CSR practices of Chinese firms there. Regardless, those that exist indicate that Chinese firms do not shun places with high labor standards, tend to let their acquisitions maintain their existing practices, and conform to local employment practices (which is not necessarily a good thing for workers), though there have been some issues. As many BSR countries have high standards when it comes to worker rights and environmental protection, it will be important to ensure Chinese investors are aware of their legal and normative requirements. Still, if one of the BSR's main attractions to Chinese businesses is its technology, then concerns about Chinese firms harming workers and the environment are reduced. Nevertheless, Chinese firms are interested in the BSR's infrastructure, manufacturing, and resource sectors, too, and thus it follows that BSR governments need to be attentive to COFDI's employment and environment implications.

Yet another political issue pertaining to COFDI is its effect on Chinese foreign policy. Conceivably, it might direct Chinese foreign policy attention or lead to favoritism towards those countries that welcome COFDI, offer Chinese investors the best treatment, or that host the greatest amount of COFDI. In most existing cases, though, the correlation seems to be thin — Beijing remains focused on those countries that represent the biggest security and economic challenges or that are its most important overall security/economic partners.

What has been seen, though, is that China's increasing economic stake/investments in other countries is pushing it to become more active abroad on the diplomatic, military, and security front.

In regards to the former, it is offering "good offices" in Myanmar and South Sudan in an effort to stabilize the political environment. As COFDI in the BSR expands, if there are, in the future, internal political problems in any BSR country, it is conceivable that Beijing might try to get involved diplomatically to ensure its economic interests are protected. BSR countries need to prepare themselves for this possibility and to reflect upon its implications for their political interests individually and collectively.

5. A Look at Some Major Non-Real Estate Deals

Space constraints and the need for focus make it impossible to present mini-case studies herein on a large number of Chinese investments in the BSR so the material below provides background information on just eight large, non-real estate deals. The deals that were selected are diverse from a geographic and sectoral perspective, include newer and older deals with a track record (though this, too, is limited), are relatively large (because information is available and they probably have significance), and do not have China's State Administration of Foreign Exchange (SAFE) or China Investment Corporation (CIC) as investors. Given that data on the eight mini-cases is, in many cases, scarce, this section eschews offering conclusions about their meaning as such an endeavor would be superficial. Regardless, such information should be developed in the future so more generalizable conclusions may be developed.

Case #1-Lenovo-Medion (Germany): In 2011, Lenovo Group, a Chinese computer firm, purchased 80 percent of German electronics retailer Medion for \$900 million and obtained two seats on Medion's Supervisory Board. Lenovo's goal in buying a majority stake in Medion was to increase its marketing channels in Europe, particularly Germany, and provide a foundation for increased economies of scale, which would directly and indirectly boost product margins. The deal followed on the heels of a joint venture (JV) deal with NEC Corp. involving the sale of Lenovo products in Japan. Pursuant to the terms of the transaction, there was not supposed to be any reduction in jobs or sites or changes to Medion management. A perusal of the Medion website and news reports do not indicate any noteworthy improvement in Medion's performance following the acquisition or any significant, adverse events.

Case #2-China National Chemical Corporation/ChemChina-Elkem (Norway): In 2011, Orkla, a Norwegian conglomerate, sold one of its units Elkem, which produces high-grade silicon, carbon, and other foundry products for the solar, computer, and other sectors, to China National BlueStar, eighty percent owned by ChemChina, for \$2 billion. The deal offered BlueStar top notch technology, managerial expertise, energy efficient production processes, and cheap energy supplies. According to Chinese media, the acquisition, which was followed by "aid" and "investment," has enabled Elkem to boost production significantly, expand R&D, and create an integrated value chain which has widened the firm's input and market options.

Case #3 - China Minsheng Investment Group/CMIG-Sirius International Insurance (Sweden): In 2015, CMIG, a private investment fund, purchased 70 year old Swedish firm Sirius International Insurance for roughly \$2.5 billion, with the deal concluded in 2016. It is not entirely clear what motivated the investment, but a strong Chinese currency, favorable target asset prices, and a desire to gain a "foothold in the Bermuda reinsurance market," a path to better returns and diversification, all may have been relevant. In early 2017, a top CMIG official reported that CMIG has retained all Sirius employees and helped Sirius expand into Asia. The latter seems to be one factor that propelled Sirius executives to embrace a deal. The revenues and assets of Sirius have been growing according to information on the Sirius Group website, but it is not clear to what extent this is attributable to the CMIG acquisition.

Case #4 - Midea Group-Kuka (Germany): In 2016, Midea Group, a Chinese home appliance company, launched a \$5 billion deal for Kuka, a Germany producer of industrial robots. The purpose of the deal was to help Midea move up the value chain, gain products and services that could satiate it and Chinese manufacturers' need to cut costs, and contribute to Beijing's quest to become a leader in advanced industrial sectors. To win acceptance of the deal, Midea said it would allow, for Kuka to operate independently, keep the extant management team, protect the firm's sites, jobs, and brands for a period of time, would help it grow its business in China, and would "support Kuka's local supply chain and distribution." At this point in time, it is not clear to what extent the Midea acquisition really will boost the prospects of Kuka in China or elsewhere, but there are certainly high expectations regarding the former.

Case #5 - Tencent-Supercell (Finland): More than one year ago, Tencent, a leading Chinese video game and social network firm, bought Supercell, a Finnish mobile games company for \$8.6 billion from Japan's SoftBank Group as a path to gain access to new territories at a time when the China market was becoming increasingly saturated, to, relatedly, gain access to the developed market, and gain new gaming content. According to the terms of the deal, which was China's second largest in 2016, Supercell's management would not change and the company will remain in Finland. Supercell viewed the deal as enabling it to remain private and gain access to the huge online gaming community in China. It is not evident what incremental impact the acquisition has had on Supercell, but news reports make clear that the Finnish firm remains highly profitable and operates essentially the same as before.

Case #6 - Three Gorges-EuroSibEnergo (Russia): In 2010 or 2011, Chinese hydropower firm Three Gorges invested around \$2.4 billion in Russia's EuroSibEnergo, the country's second largest electricity producer and a subsidiary of EN+ Group. The two companies formed a joint venture (JV) called YES Energo to build three new plants, two hydroelectric and one natural gas-fired, that would increase Russia's capacity to supply China's voracious electricity needs. The JV's power plant construction plans apparently later encountered some environmental and local opposition that may have resulted in the reduction or elimination of one of the plants. Based on publicly available information, it is not clear exactly how much money ultimately was invested in EuroSibEnergo or what the impact of this investment was on the firm's growth, profitability, employment, and so on.

Case #7- CNPC-Novatek: In 2013, CNPC bought a 20 percent stake in Russia's Novatek's \$20 billion Yamal LNG project. The project, valued between \$2.24 to \$5.4 billion by different sources, was seen as a way to ensure completion of the project, which, in turn, would, among other things, boost CNPC's investment returns and gas supplies, increase China's oil and gas reserves, give China a foothold for "shaping regional rules and norms relating to gas reserves in the region," and enhance Sino-Russian relations. Reports suggest that the Yamal project, which is the "first integrated project for polar natural gas exploration, development, liquefaction, and transportation," began operations this year partly because of Novatek's partnership with CNPC. Observers note that the transaction gave Novatek, an opportunity to export gas abroad, which was a privilege previously enjoyed by only one other Russian firm (Gazprom), strengthened its position in the Arctic, a key future area for energy exploitation, and boosted its financial returns.

Case #8 - Power Construction Corp. of China/PowerChina-RusHydro (Russia): In the fall of 2014, RusHydro, Russia's largest hydropower producer, entered in a deal with Power Construction Corp. of China Ltd. (PowerChina), which supplies engineering and construction services, to form a JV for the construction of a hydropower station worth \$2.96 billion near St. Petersburg, Russia. PowerChina, which would have a 49 percent stake in the deal, felt the deal, beyond its intrinsic worth as a source of work and supply opportunities, had value in terms of contributing to Russia's electricity and road development. According to RusHydro's 2016 CSR report, project assessments have been completed, but the two sides are still working on its financial and engineering details. Concrete details are lacking, but it appears that RusHydro's partnership with PowerChina is giving the former opportunities to develop mini-hydropower plants in Russia as well as other alternative energy projects such as wind power, obtain financing otherwise inaccessible to it, and engage in projects outside Russia.

6. The BRI and COFDI in the BSR

Background: In 2013, Chinese President Xi Jinping unveiled two schemes, the Silk Road Economic Belt (SREB) and Maritime Silk Road Initiative (MSRI), both part of a larger program termed “One Belt, One Road,” now the “Belt and Road Initiative” (BRI). The BRI, which ambitiously spans from China’s East Coast to western Europe, through Central Asia and Russia (the SREB) and through Southeast Asia, South Asia, Africa, and the Middle East (the MSRI), is supposed to entail tens, if not hundreds, of billions of dollars hard infrastructure projects, new financing institutions (such as the Asian Infrastructure Investment Bank and Silk Road Fund) and funds, and soft infrastructure such as bilateral investment treaties (BITs) and customs clearance agreements. The aforementioned hard infrastructure projects, which include airports, ports, roads, high-speed railways, and special economic zones (SEZs), are supposed to bring about a massive improvement in sub-regional, regional, and global connectivity allowing for new levels of trade, investment, and people-to-people exchange.

For China, there are many motivations behind its scheme. These include, but are not limited to, the goal of increasing export opportunities so China may get rid of its surplus capacity, improving the availability and security of resource flows, giving Chinese businesses new investment, contracting, and supply opportunities, facilitating the internationalization of China’s currency the renminbi (RMB), and helping development in its less developed provinces. Participant and prospective participant nations, which seems to include all nations on earth, are excited about the BRI because they believe that it will help them obtain financing on favorable terms, boost their manufacturing and export opportunities, and diversify their economic relationships.

Many also anticipate it will bring in massive infrastructure investment and lure in Chinese companies. In this vein, they have been signing all kinds of BRI-related agreements and memoranda of understanding, enthusiastically welcoming Chinese leaders, and dispatching delegations to Beijing to discuss BRI opportunities.

There seems to be an assumption that China’s BRI will succeed — we are talking about the world’s second largest country and one with financial muscle after all — and that the BRI will deliver the goods that its participant nations think it will. However, there are numerous challenges facing the BRI and many of them are quite daunting. First, the assumption that China has or will provide all the necessary financing on terms participants desire is highly questionable. The reality is that China has many domestic and international claims on its resources, is cautious about its lending (especially after encountering problems in Venezuela), and typically *lends* on market terms. Second, there are numerous problems with and in countries along the SREB and MSRI routes that will limit or slow the progress of China’s schemes. Third, Chinese firms, even SOEs, are influenced by market considerations so their investment decisions and operations will be guided only partly by the aspirations of host countries. Fourth, China’s connectivity schemes will work best when they connect, but there is limited evidence to suggest projects in individual countries are being integrated with one another across borders. Fifth, BSR countries have internal economic hurdles that they must surmount to maximize their gains from the BRI. The punchline to the above is that while there undoubtedly will be opportunities emerging from the BRI for the BSR, there should be less hope and hype and more serious thought about it.

7. Conclusion and Recommendations

This report tackles the increasingly salient subject of COFDI in the BSR. In this vein, it gave background on COFDI as well as COFDI in the BSR. It showed that COFDI really started flowing into the BSR after the 2008 GFC, has been focused on BSR heavyweights Germany and Russia, and has been concentrated in the resource and technology sectors. It further has highlighted a number of political and economic matters associated with COFDI such as its national security ramifications, its effect on national economic competitiveness, and its consequences for economic development. This report also presented eight mini-cases for informational purposes, though these cases are not rich enough to yield general conclusions. Lastly, I delved into China’s BRI and its potential implications for the BSR. The balance of this section offers various policy recommendations and offers some concluding remarks.

Five Policy Recommendations:

1. Accelerate data development: First and foremost, there is an incontrovertible need for more and better macro- and micro-level data on COFDI in the BSR. Progress in improving macro-level data could be made through a collaborative project involving BSR Central Banks, national statistical agencies, and other relevant economic bodies discussing their data gathering techniques, the ways they conceive and measure COFDI (and other FDI flows), and the differences between their data and those of other leading sources. At the micro-level, it would be beneficial if BSR research institutes and university business, economic, and political science units worked with each other and others outside the BSR to undertake systematic and comparable studies of major COFDI transaction. Too often there is no post-transaction review of deals which means analysts often proffer conclusions using outdated and/or incomplete information, which limits the ability of BSR actors to understand the real implications of COFDI and the context that gave rise to them. Moreover, case studies of individual BSR transactions often do not use the same criteria which makes it very difficult to draw general conclusions about their political and economic implications.

2. Collaboratively promote investment: There is natural tendency for countries to conduct investment promotion parochially. However, given the small (relative) size of many BSR economies, this not sensible: they do not have enough big enough markets, resource endowments, or brands to make themselves sufficiently attractive to Chinese investors. Moreover, if part of the rationale behind Chinese companies investing in individual BSR countries is to access the BSR in its entirety or regions adjoining the BSR, then multilateral investment promotion may help in, among other things, bringing more Chinese firms to the region and helping ensure their investments succeed. Finally, collaborative investment promotion has the potential to develop sectoral (e.g., power, transport, or technology) or nationality (e.g., Chinese firm) clusters that produce agglomeration effects.

3. Create and enhance investment review processes: As noted above, there are a number of political and economic issues associated with COFDI and it is better that BSR countries prepare now rather than later to deal with such issues. Individual BSR countries undoubtedly will have different conceptualizations of national security, national economic independence, development, environmental protection, and labor rights. Regardless, it would be fruitful for them to gather to discuss their conceptualizations, the nature and successes/failures of their investment review processes (if any), the ways that they will gather (and potentially share) data for such review processes, the upsides and downsides of other countries' investment review processes, and so on.

4. Watch the incentives: To date, there have been no reports of BSR countries offering massive investment benefits such as tax breaks, subsidies, or legal flexibilities to attract COFDI. Careful thought should be given to the merits of offering such incentives, partly because the benefits of COFDI have been understudied and it is thus difficult to know the true costs and benefits of such incentives. Also warranting consideration is the potential for such investment incentives to lead to a "race to the bottom" among BSR countries not just in regard to luring Chinese companies, but investors from other regions that likely would demand incentives similar to what Chinese firms obtain.

5. Prepare for divide and conquer: China has used its financial, investment, and trade linkages with Europe, Latin America, and Southeast Asia to play countries off against one another on economic as well as political issues. The effects of this have been seen at the bilateral level and also on the regional organizational level such as the Association of Southeast Asian Nations (ASEAN) in the case of Southeast Asia and the European Union in the case of Europe. With the continued growth of trade, investment, and other ties between China and BSR countries, it is natural that China would attempt to leverage its economic relations to achieve its political and economic aims. BSR countries need to prepare for this eventuality. They also need to prepare for the possibility that China will become increasingly active in their domestic spheres (not necessarily illegally) to defend and advance its investments.

Globally, COFDI has been soaring since 2005 and thus many have long been paying attention to its potential benefits and costs. COFDI in the BSR, however, is a more recent phenomenon and thus has not received similar attention. However, given China's economic requirements, the needs of Chinese companies, and the situation in BSR countries, this is problematic. This report strongly advocates more study and highlights many measures BSR countries should take individually and collectively to address the increasingly salient issue of COFDI

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