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The economic impact of China on the Baltic Sea region

Some recommendations for policy-makers

By Jean-Paul Larçon

CENTRUM BALTICUM

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The cooperation between China and the countries of the Baltic Sea region is growing rapidly in terms of trade and investment. It is a direct consequence of China's 'Go Global' strategy, the investments of Nordic companies in China, and the accelerated internationalization process of large Chinese corporations since China's entry into the World Trade Organization in 2001. China's "Belt and Road" initiative launched in 2013 and the Russia–China economic cooperation, especially in the field of energy and transport, are creating new opportunities and challenges in the Baltic Sea region countries in terms of transport connectivity, economic cooperation, and collaboration in the high-tech sector.

Keywords

Baltic Sea region, Belt and Road Initiative, Eurasia, China, Russia, Northern Sea Route, business strategies, economic cooperation, foreign direct investment, international trade, transport corridors.

Introduction

German and Scandinavian companies have developed a strong presence in China in the 1980s and the 1990s in the context of China's "open-door" policy announced by Deng Xiaoping in December 1978.
Among the forerunners, Volkswagen established its first joint venture in China with Shanghai Automotive Industry Corporation (SAIC) in 1984, and ABB its first manufacturing joint venture in Xiamen in 1992. Most European firms started investing in China in mid-nineties and have continued investing successfully since, not only to serve the Chinese market but also to export from China to the world. These foreign investments had a major impact on the transformation of the Chinese economy and the massive transfer of technical knowledge and managerial skills to Chinese companies.

The opposite move - that is Chinese foreign direct investment (FDI) in Europe and the Baltic Sea region - is more recent. China's "Go Global" policy, promoting Chinese companies' expansion in foreign markets and encouraging outward FDI was formulated in 1999 and Chinese firms started investing abroad after 2001, date of China's entry into the World Trade Organization (WTO). Chinese annual flow of FDI to the European Union (EU) started accelerating in 2008 and reached in 2016 a higher volume than the annual EU FDI flow to China.

Among EU BSR countries, Germany has been by far the largest recipient of Chinese foreign direct investment during the period 2000-2015, followed by Sweden, Poland, Denmark, Finland, and the Baltic States. During this period, the largest investments in Nordic-Baltic countries was the acquisition of Volvo cars by Zhejiang Geely Group in 2010. In 2016, a consortium led by Tencent Holdings, China's leading provider of internet value-added services, acquired 84 percent of Supercell, the Helsinki-based game developer, for 7.6 billion euros. Chinese firms demonstrate a growing interest in opportunities for investment in the BSR region, especially in the fields of natural resources, energy, and technology.

1. China and the Baltic Sea region: towards closer economic cooperation

The move towards a closer economic cooperation between China and the Baltic Sea Region (BSR) is due to many factors, including the growth of China-EU trade, China's Belt and Road Initiative, Chinese investments in Central, Eastern and Southern Europe, and the evolution of China-Russia relations.

The growing importance of China-Europe trade

In 2006 China and the US were the two largest goods trading partners of the European Union. China was accounting for 15% of total extra-EU trade in goods in 2016 compared with 10% in 2006. From 2006 to 2016, China's share in EU imports increased from 14% to 20%, and China's share in EU exports from 6% to 10%. Many difficulties are still to come in the negotiations between China and the EU regarding trade, investment, and economic cooperation, but there is already a high degree of interdependence between the two blocs, which both want to remain open to free trade. The EU needs currently to decide whether granting or not to China the "market economy status".

China became for the first time Germany's most important trading partner in 2016, with German imports from and exports to China rising to 170 billion euros. China is the largest trading partner in Asia of Nordic countries, and the trade between China and Nordic countries has been consistently growing since China's accession to the WTO in 2001.

China's Belt and Road Initiative

The speech of Chinese President Xi Jinping in Kazakhstan in 2013, which was the first official announcement of China's Belt and Road initiative (BRI), has been followed rapidly by a series of China-led infrastructure projects in Asia, Europe, and Africa aiming at improving connectivity and international trade. These large projects are supported financially by Chinese policy banks, special funds, and/or new multilateral financial institutions such as the Asian Infrastructure Investment Bank (AIIB). Russia, Germany, Nordic countries, and Poland are members of the AIIB while US and Japan declined to join.

Both wings of the Belt and Road Initiative – the Maritime Silk Road (MSR) and the Silk Road Economic Belt (SREB) have a direct impact on the Baltic Sea Region (Map 1). The MSR has a major influence on maritime trade routes, investments in port infrastructure, marine engineering and competition between leading shipping companies. The SREB investments in railways infrastructure and logistic services improve significantly the connectivity between China, Central Asia, and the Nordic-Baltic region.

Map 1 The "Silk Road Economic Belt" and the "Maritime Silk Road"

Source: Xinhua, 2015

China's cooperation with Central, Eastern, and Southern Europe

Chinese diplomacy introduced the "16+1" framework of cooperation between 16 Central and Eastern European countries (CEECs) and China at a summit in 2012 in Warsaw. The objective of the 16+1 framework is to promote cooperation in the fields of investments, transport, finance, science, education, and culture. The CEE countries are ranging from the Baltic Sea to the Black Sea and the Adriatic, including eleven EU Member States and five Balkan countries, and Chinese investments in infrastructure in the region could contribute to a better transport connectivity between the Baltic Sea and Southern Europe.

The flagship projects of China in the broad Central, Eastern, and Southern Europe region include the huge investments of China Cosco shipping company in the Greek port of Piraeus and the Chinese-led project of the Belgrade-Budapest high-speed rail project.

China-Russia economic cooperation

Russia seeks to combine the long-term objectives of its Eurasian strategy with the benefits of China's flexible Belt and Road initiative. After a mixed reception by Russian authorities to the BRI in 2013, President Putin and Xi signed an agreement in 2015 linking the Belt and Road with the Eurasian Economic Union (EEU), pledging to create a "joint economic space" in Eurasia. China' BRI and the Russia Eurasian Union have not the same long-term objectives, but the two countries are developing a pragmatic economic cooperation especially in the field of energy and transportation across Eurasia.

Chinese investment in the Yamal LNG project in Siberia in 2016 is a good illustration of the synergies between the two countries in terms of capabilities and resources as well as the new perspectives of economic development and transportation along the Northern Sea Route. China and Russia also develop other key projects in the energy and transport sector such as the "Power of Siberia" natural gas pipeline project signed in 2014 transporting Yakutia's gas to Vladivostok and to China, and the Moscow-Kazan high-speed railway (770 km) project which could be partly financed by public-private partnerships (PPP) and the financial support of China in the form of a long-term loan of $6.9 billion.

Chinese investments in the St. Petersburg region are, by comparison, quite limited with real estate investments in the "Pearl of the Baltic Sea" project initiated in 2005 and the creation of a China-Russia High-Speed Rail Research Center in 2016.

2. Entry Strategy of Chinese Firms in the Baltic Sea region

Compared to their predecessors, western or Asian multinationals, Chinese firms follow a path of accelerated internationalization. They invest abroad either to increase their competitive advantage in specific sectors or to compensate their competitive disadvantage. They acquire the assets that they miss to increase their leadership at the Chinese and international level: natural resources, advanced technology, manufacturing hubs, distribution networks, and/or international brands. Thus, their regional targets are not primarily defined by geography, but by the opportunity to find the assets they are looking for. Some companies like Huawei entered Europe step by step by organic growth, but the preferred mode of entry of Chinese firms in Europe in the last ten years was M&A.

Huawei, founded in Shenzhen in 1987, is one of the largest global telecommunications equipment maker and among the top three vendors of smartphones. The company's strategy and corporate culture are innovation-driven, with 43,600 employees engaged in R&D and massive R&D spending up to 14.2% of overall revenue. The first Chinese investment in Sweden was the opening of its first European office in Kista Science City near Stockholm in 2001. In 2016, Huawei had over 1,200 R&D employees in Europe working in sites located in leading Information and Communications Technology (ICT) clusters based in eight European countries including Sweden, Finland, and Germany. Huawei's European headquarters are in Dusseldorf (Germany) with R&D centers in Nuremberg, Munich, and Berlin. In 2017 Huawei Technology Sweden had some 400 R&D engineers and Huawei Finland R&D Center, established in Helsinki in 2012, some 160 employees.

This localization policy contributes to Huawei quest for markets, technology, and talents thanks to the close links with telecom operators, business partners, and local research institutions. Huawei's subsidiary Huawei Marine is working with Tele Greenland to install submarine line terminal equipment for the network connecting Greenland with Iceland, mainland Europe, and North America. Huawei works also with Cinia Group, Finland ICT company, on the C-Lion1 submarine cable laying under the Baltic Sea and connecting Central Europe to Finland and Nordic countries.

Leading Chinese ICT companies such as Huawei and ZTE, China Mobile, China Telecom, China Unicom, Alibaba, Tencent, Baidu, and Xiaomi have a strong interest for China-Europe digital cooperation in such areas as 5G, cloud computing, the internet of things, big data, and e-commerce, which are also areas of excellence of BSR countries

Zhejiang Geely, which entered the automobile industry in 1997, acquired Volvo Cars from Ford Motor in 2010 for $1.8bn with the financial support of Bank of China (BoC) and a Chinese municipal government. Volvo Cars' stakeholders and Swedish public opinion were worried about the potential risks regarding employment in Sweden, potential loss of technology, and risk of dilution of brand identity. Geely Chairman Li Shufu was quoted as saying "Volvo is Volvo, and Geely is Geely": the two companies would be kept separate.

The deal opened the door of the Chinese market to Volvo Cars and to the rapid development of its capacity of production in China with a manufacturing plant in Chengdu producing for both local sales and exports, and a second plant in Daqing, China's northernmost province. In 2017, a new car brand was launched, Lynk & Co, positioned in between Geely's Emgrand brand and Volvo brand. The factory, located in Luqiao, 350 kilometers

south of Shanghai, is owned by Zhejiang Geely but operated by Volvo Cars. Geely's ownership has opened the way to a complete strategic renewal and development of Volvo Cars' global presence. In 2016 Volvo Cars largest markets were China (17%), the US (15%), Sweden (13%), the UK (9%) and Germany (7%).

China's Midea Group, one of the world's largest home appliance manufacturer, founded in 1968 in Foshan, Guangdong province, took over German robot-maker Kuka in 2016 for 4.5 billion euro. It raised concerns in Germany and at the EU level about technology falling into foreign hands. Midea's portfolio of activities before the acquisition included consumer appliances and heating, ventilation and air-conditioning systems. Following the movement initiated by LG and Samsung in the market of connected appliances development, Midea had initiated in 2015 a strategic move towards smart appliances and connected manufacturing: the "double-smart" strategy of "smart home" and "intelligent manufacturing". The strategic plan included investments in innovation, quality improvement, IT processes, capability improvement for e-business, and automation. In 2015 Midea Group created two joint-ventures with Yaskawa Electric of Japan, one of the world's top suppliers of robots. Then came the acquisition of Kuka, and the opportunity for Midea to acquire rapidly a leading market share of China's robotics market which is becoming the largest robotics market in the world.

The Kuka deal gives to Midea the capacity to innovate in its traditional appliance sector, to grow rapidly in the robot business, and to serve the objectives of the national policy "Made in China 2025". The Chinese plan, inspired by German "Industry 4.0", focuses on innovation-driven manufacturing, quality and sustainability, and automation; it highlights 10 priority sectors: IT, robotics, aerospace, maritime and rail equipment, electric cars, power equipment, agriculture equipment, new material, and bio-pharma.

Cooperation with Chinese firms can be a very interesting option for innovation-driven European companies operating in the Nordic-Baltic region, looking for growth opportunities and financing to support their R&D effort at home.

3. China's Belt and Road Initiative and the Baltic Sea region

The Maritime Silk Road and the BSR

The majority of China-Europe trade is conducted along the maritime road through the Suez Canal, and Germany is China's leading trade partner in Europe followed in the BSR by Poland, Sweden, Denmark, and Finland (Table 1).

Trade with China is very important for the ports of the Baltic Sea and the North Sea, the economic development of their hinterland, as well as their maritime industry. The maritime transport chain is characterized by bigger container ships and the need for huge investments at two levels: port facilities and connectivity with the hinterland, which gives an advantage to the ports offering the best access to the Europe core markets such as Hamburg, Rotterdam, and Antwerp. China is the most important trade partner of Hamburg, Germany's largest port and Europe's third largest. Hamburg is also the home of the European headquarters of some 500 Chinese companies including Cosco Europe, Shanghai Baosteel, and SAIC - China's largest car manufacturer.

Table 1 Trade in goods between China and EU Baltic State Region countries (2016)

Country	Import Value to the EU (billion euros)	Export Value from the EU (billion euros)
Germany	93.8	76.1
Poland	14	1.7
Sweden	7.1	4.9
Denmark	5.6	3.8
Finland	1.9	2.7
Lithuania	.7	.1
Estonia	.6	.2
Latvia	.4	.1
EU28	345	170

Source: Eurostat

This is why the "North Sea-Baltic Corridor" connecting the ports of the eastern shore of the Baltic Sea with ports of the North Sea, situated in Northern Germany, Belgium and the Netherlands, including roads, railways and inland waterways, should be a priority of the EU and Nordic-Baltic countries.

The Port of Gdańsk in Poland, which is the transport hub for 40% of China-Poland trade, could also take advantage of China's Belt and Road initiative, and has already made huge investments in infrastructure. However new investments are needed for better connectivity with the hinterland. One of the priorities of the Port of Gdansk authority is the navigability of the Vistula River and the system of waterways connecting Gdańsk to Warsaw and to the Black Sea.

In Lithuania, the authorities of the Port of Klaipėda are also studying the possibility of cooperation with China Merchants Group for the creation of a new deep-water port able to receive large container ships of the Baltmax class.

The development and international trade and overcapacity in container-shipping industry lead at the same time to consolidation in the industry and the development of operational alliances. Denmark's Maersk Line has entered a partnership with Geneva-based Mediterranean Shipping Co. (the "2M alliance") while France's CMA-CGM Group announced its collaborative agreement with Cosco Shipping, Evergreen and OOCL (the "Ocean Alliance"). A major factor of cost reduction in the framework of this operational partnership is ship sharing and port terminal sharing.

On the Chinese side, Chinese State-owned enterprises such as Cosco Shipping and China Merchants Group are leading the operations along the MSR with the support of Chinese-led financial institutions. On the European side, the development of China-Europe trade leads to a concentration of activities in a few major transportation hubs in BSR countries and the needs of specialization of other seaports and land ports in the hinterland. It creates opportunities for European specialized shipyards and marine industry for Chinese clients in Europe and in China. Wärtsilä, for example, the Helsinki-based company manufacturing engines for the marine and energy markets, develops successfully its cooperation with Chinese clients and partners through various forms of licensing agreements, joint ventures, and wholly owned subsidiaries, which contributes to its global competitive advantage.

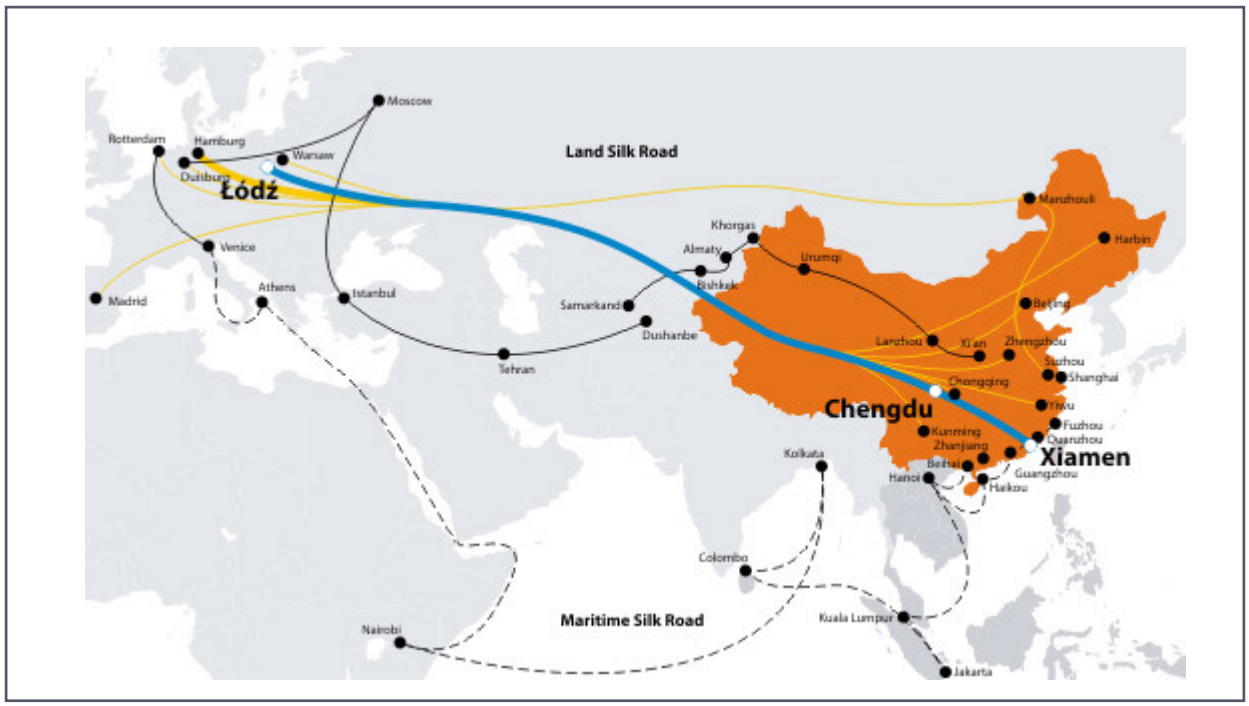
The Silk Road Economic Belt and the Baltic Sea Region

The second pillar of China's BRI, the "Silk Road Economic Belt", aims at better railways connectivity across Eurasia along different land roads including the "Northern Route" through Siberia crossing Russia from Northern China

to Moscow and the "Southern Route" from Western China to Kazakhstan, Russia, Belarus, and Central and Eastern Europe. Chinese investments along these routes are a great opportunity for Northern Europe countries to develop their economic cooperation with Central Asia, especially Kazakhstan, and Chinese western, central and northern provinces.

The Chengdu-Europe Express Railway Service operating between Chengdu in southwestern China's Sichuan province and Łódź in Poland began operating in 2013: a 10 days' journey for container trains (Map 2).

Map 2 The China Chengdu-Europe Express Railway Service



Source: Baltic Transport Journal

The city of Kouvola in Finland, which offers a good train connection to the ports of Helsinki and HaminaKotka, has opened in 2017 a new Kouvola-Xi'an rail link connecting Kouvola (Finland) to Xi'an (China) in 10-12 days. Chongqing (Southwest China) - one of China's four municipalities directly under the central government and the world's biggest laptop manufacturing hub - is the starting point of the Chongqing-Xinjiang-Europe Railway (Yu'Xin'Ou Railway) covering the 11,000 kilometers between Chongqing to Duisburg in Germany in 12 days compared to some 50-55 days by the Maritime Route. The Baltic States and Finland have also a direct role to play in the China-EU rail connection.

In 2017, 7 railways companies - Belarusian Railway, China Railway Corp, Deutsche Bahn, Kazakhstan Temir Zholy, Poland's PKP, Russian Railways, and Ulaanbaatar Railway - signed an agreement to improve the container train services between China and Europe: reducing transit times, coordinating the development of infrastructure, manage efficiently the break-of-gauge operations between the Russian and international standard gauge, introducing IT support for electronic exchange of freight data, and integrating custom procedures. Deutsche Bahn and China Railways announced in 2016 new orientations of their cooperation in three directions: rail freight transport, high-speed train maintenance, and infrastructure projects in third countries.

The objective is to triple the number of containers transported by rail along the trans-Eurasian Land Bridge by 2020, connecting China to Germany through Central Europe and Central Asia.

DB Schenker, the freight logistics subsidiary of Deutsche Bahn (DB), offers rail logistics solutions connecting Europe to some 60 key Chinese cities. BMW, Volvo Cars, VW, and France PSA are already using either the land road or a combination of railways and maritime links to transport car components between their European factories and assembly plants in China's western or northern provinces.

Chinese National Development and Reform Commission (NDRC) in 2016 rebranded all freight rail services between China and Europe under the name of "China Railway Express" – "CR Express", confirming China's commitment to developing rapidly the rail routes and transit connecting China to Europe. CRRC, the Chinese manufacturer of locomotives and rolling stock, and the world's largest supplier of rail transit equipment is leading the pack of Chinese firms operating along the SREB and looking for expansion in foreign markets.

The merger between European rail giants Alstom of France and Siemens AG of Germany announced in 2017 can be seen as an answer to this Chinese challenge. Alstom is already a leading contributor to the modernization of Kazakh railways and Siemens is very interested in participating in large railways projects in Eurasia such as the Moscow-Kazan.

"Great Stone": a Chinese land port in Belarus

A major Chinese investment in China along the SREB is the railways and logistics hub established in 2012 in Khorgos at the China-Kazakhstan frontier. Khorgos is located at the Korgas Pass, 670 Km from Urumqi, the capital of Chinese Xinjiang Uyghur Autonomous Region province and 200 Km from Astana, the Kazakhstan capital. This model of logistics hub, associating a free trade zone and industrial park, is developed by China all along the Belt and Road: in Asia, in Europe, and in Africa. These investments are creating new opportunities for development in Kazakhstan and Central Asia, contributing to the reorganization of the global value chain along the way and the possibility for local companies to develop their exports to both Europe and East-Asia. The Sino-Kazakh terminal located at the Lianyungang seaport in Jiangsu Province in eastern China is offering, for example, good connections to the Chinese ports such of Qingdao, Dalian, and Shanghai, and the ports of Busan (South Korea) and Osaka (Japan).

On the Northern Europe side, Belarus could play a similar role than Khorgos, and Chinese and Belarus authorities are developing near Minsk a logistics hub called "Great Stone" at the junction of the Eurasian Economic Union, the European Union, and the new Silk Road Economic Belt. Belarus is a founding member of the treaties creating the Eurasian Customs Union in 2011 and the Eurasian Economic Union (EEU) in 2014. But Belarus foreign trade is already relatively geographically diversified: Russia accounted for 45.1 percent of export and more than 57% of import in January-June 2017 with the EU – second-largest trading partner Russian Federation – accounting for 26.7 percent of export and one-fifth of import. Minsk has a good infrastructure network of motorways, railways, and air routes, and is located 700 km from Moscow, 500 km from Warsaw, and 1,060 km from Berlin.

The logistics hub "Great Stone" is managed by two Chinese State-owned enterprises (SOEs): China National Machinery Industry Corp (Sinomach) and China Merchants Group, and is financed by Chinese funds such as the China-Belarus Industry Fund of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC).

Chinese firms have started investing in Minsk. Midea Group is producing home appliances (microwave, water heaters, water coolers and cooking tops) in partnership with Belarus Horizont for exports in the Community of Independent States (CIS). Zhejiang Geely, in partnership with Belarusian truck maker Autoworks (BelAZ), is assembling cars from semi-knocked-down kits imported via containers from China and exported to Russia. Belarus wants to expand its cooperation in transport, logistics, and transit with Latvia and Lithuania in order to promote its exports through the Baltic ports, and the joint projects between the three countries are eligible for EU financial support.

Klaipeda seaport in Lithuania, which is 457 km from Minsk, is in competition with Riga for Chinese investments. Riga's port authorities consider creating in Riga a terminal similar to the Sino-Kazakh terminal of Lianyungang.

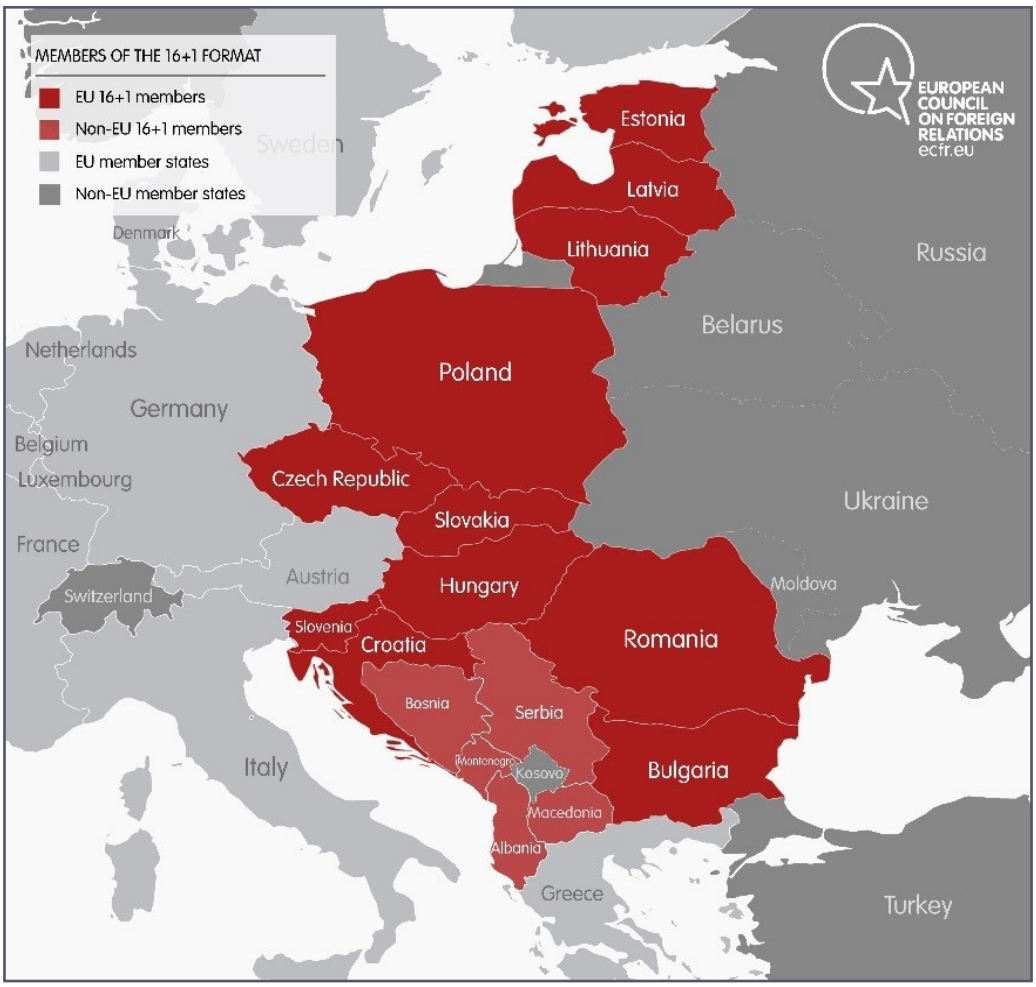
The implementation of the "Rail Baltica" greenfield project connecting Helsinki, Tallinn, Riga, Kaunas, Vilnius, and Warsaw, aiming at a better connectivity between Finland, the Baltic States, and Poland, could also contribute to the BSR attractiveness from the point of view of China-Europe trade through Eurasia.

China's entry into Central Europe and the 16+1 framework

Poland and the Baltic States are active participants of the 16+1 framework and could take advantage of their geographic position at the crossroad between two major axes of communication: between Russia and Western Europe, and between Northern and Southern Europe (Map 3).

China is the second trade partner of Poland after Germany and China's largest trade partner in Central and Eastern Europe, accounting for 30% of the China-CEE Countries trade. Polish authorities, on the one hand, worry about the trade deficit between the two countries but, on the other hand, would like to attract Chinese investments in the area of energy and transport infrastructures such as in the logistics hubs along the Belt and Roads such as Gdańsk seaport and Łódź.

Map 3 The "16+1 framework" and Central and Eastern European countries (CEECs)



Source: ECFR

In terms of Chinese FDI in the CEE countries, Hungary is the number one recipient of Chinese investment (Table 2).

Table 2 Chinese FDI in selected countries of Central and Eastern Europe in 2000–2016 (EUR million)

Hungary	2,051
Poland	936
Romania	889
Czech Republic	569
Bulgaria	337
Slovakia	49
Lithuania	33
Estonia	29
Slovenia	9
Croatia	4
Latvia	3

Source: Rhodium Group

The main Chinese project in Hungary is the 350-km high-speed railway link between Belgrade, Serbia and Budapest, Hungary. The $1.57 billion budget of the Hungarian section of the project would be partly financed by a loan of China EximBank, and Chinese companies, China Railways and China Communications Construction Co, should have a key role in the implementation.

However, in 2017, the project still needed the approval from the EU Commission in terms of compliance with EU rules regarding public tenders for large transport projects. The logic of the Belgrade-Budapest project is linked to the massive Chinese investments in Piraeus. Cosco has invested regularly from 2009 to 2015 in terminal infrastructures in Piraeus, the port of Athens, and finally acquired a 67% stake in the Port of Piraeus for 368.5 million euros in 2016. These investments contribute to saving from four to ten days of transport than using alternative ports of Northern Europe such as Hamburg, Rotterdam, and Antwerp.

Chinese and foreign companies such as HP, SONY, ZTE, and Huawei have chosen Piraeus as a major hub in the Mediterranean Sea, offering a good access to Europe, the Middle East, and North Africa. But the development of the hinterland has to follow the development of the port in order to reach European core markets through the CEE countries. Cosco is already promoting a new "China-Europe Sea-Land Express service", with containers shipped from China to central and eastern Europe via the port of Piraeus.

Chinese initiative in the 16+1 framework is currently stimulating new proposals on the European side. In 2015, the Croatian government put forward the "Three Seas" initiative, connecting the Baltic, the Black and the Adriatic Sea. Chinese response was an expression of interest by Chinese National Development and Reform Commission (NDRC) stressing that China was interested in connecting the "Adriatic-Baltic-Black Sea Initiative" and the Belt and Road project.

4. China' Arctic Policy and the Northern Sea Route

Russian Arctic policy

The development of Arctic resources and the sea traffic along the Northern Sea Route (NSR) are among the key objectives of the Russian Federation's policy for the Arctic (Map 4). The Northern Sea Route is the domestic route connecting Russian seaports of the Northern basin such as Arkhangelsk and Murmansk, Siberian river ports, and the seaports of the Russian Far East such as Vladivostok. It is also the shortest shipping route between European and East Asian ports of China, Japan, and Korea.

An ice-free Arctic could significantly reduce transportation costs by cutting the distance from Western Europe to Japan or China by 20% to 40%.

The first passage from Russia's northernmost port of Murmansk to China through the NSR was made in in 2010 by the Russian gas tanker 'Baltica'. The development of the Northern Sea Route is one of the key project included of the "Transport Strategy of the Russian Federation till 2030" approved by Prime Minister Medvedev in 2015. Huge investments are needed for this project which includes the expansion of port capacities, connection with the hinterland, and the building of a new generation of icebreakers and ice-class vessels.

Map 4 The Northern Sea Route

Source: Arctic Portal

China's Arctic policy

China identifies itself as a "near-Arctic" state and an Arctic "stakeholder". China's Arctic policy is implemented step by step, combining political, economic and scientific interests in a long-term perspective. China applied for the status of observer at Arctic Council in 2009 and was granted this status in 2013 along with four other Asian countries - Japan, South Korea, India, and Singapore – as well as with Italy. On the scientific side, a China-Nordic Research Center (CNARC) was established in 2013 in Shanghai linking four Chinese and six Nordic research institutes working on Arctic research projects including climate change, Arctic resources, shipping and economic cooperation, and Arctic policy-making and legislation.

In June 2017, Chinese authorities, the National Development and Reform Commission (NDRC) and the State Oceanic Administration, published a document called "The Vision for Maritime Cooperation under the Belt and Road Initiative". This document mentions the interest for the "blue economic passage" connecting Europe via the Arctic Ocean. Chinese enterprises are encouraged to take part in the commercial use of the Arctic route and to participate in the sustainable exploration of Arctic resources in a responsible way. Among China' s economic priorities are the securing of energy resources and the development of the North Sea Route, as an alternative trade route between China and Europe.

China-Russia cooperation in the Arctic

The largest Chinese investment in Russia is the Yamal LNG project on the Yamal Peninsula in the Arctic Circle, which includes natural gas production, liquefaction, and shipping. The Yamal LNG project, expected to cost US$27 billion, is operated by Russian Novatek (50,1%) in partnership with French Total (20%), China's CNPC (20%), and China's Silk Road Fund (9,9%). Chinese participation includes also 15-year loans of $10.6 billion and $1.5 billion from China EximBank and China Development Bank. Shipments to China from Yamal should take about 18 days using the Northern Sea route.

In August 2017, the new ice-class LNG carrier "Christophe de Margerie", transporting liquefied natural gas, completed the trip from Norway to South Korea through the Northern Sea Route in just 19 days, 30 percent faster than the regular route through the Suez Canal. The ship, belonging to Russia's largest shipping company Sovcomflot, is the prototype for a series of 15 LNG carriers specially designed for the Yamal LNG project.

China-Russia cooperation in the Arctic goes beyond the Yamal project. Russia plans the development of a new deep-water seaport near Arkhangelsk in the White Sea for the year-round handling of large capacity vessels, operations including icebreakers during the winter season. This project is part of a broader plan and the development of the new railway route, "Belkomur", connecting Arkhangelsk to Perm in the Urals. Chinese companies including China Poly Group Corporation, Cosco Shipping, and China Eximbank have already expressed in 2017 their interest to participate in the development of the new seaport and the Belkomur railways which would cut the transportation distance for cargo from Siberia to the White Sea via the Urals by some 800 km.

Chinese investments in the Nordic-Arctic

China is investing in the Nordic-Arctic and increasing its diplomatic ties with several Arctic states. Norway has restored full political and diplomatic relations with China in 2016 after a six-year freeze due to the award of the Nobel Peace Prize to dissident Liu Xiaobo. The normalization of China-Norway ties opens the door to the negotiations of a free trade agreement, the development of Norwegian seafood exports to China, and new forms of cooperation in the energy and high-tech sector.

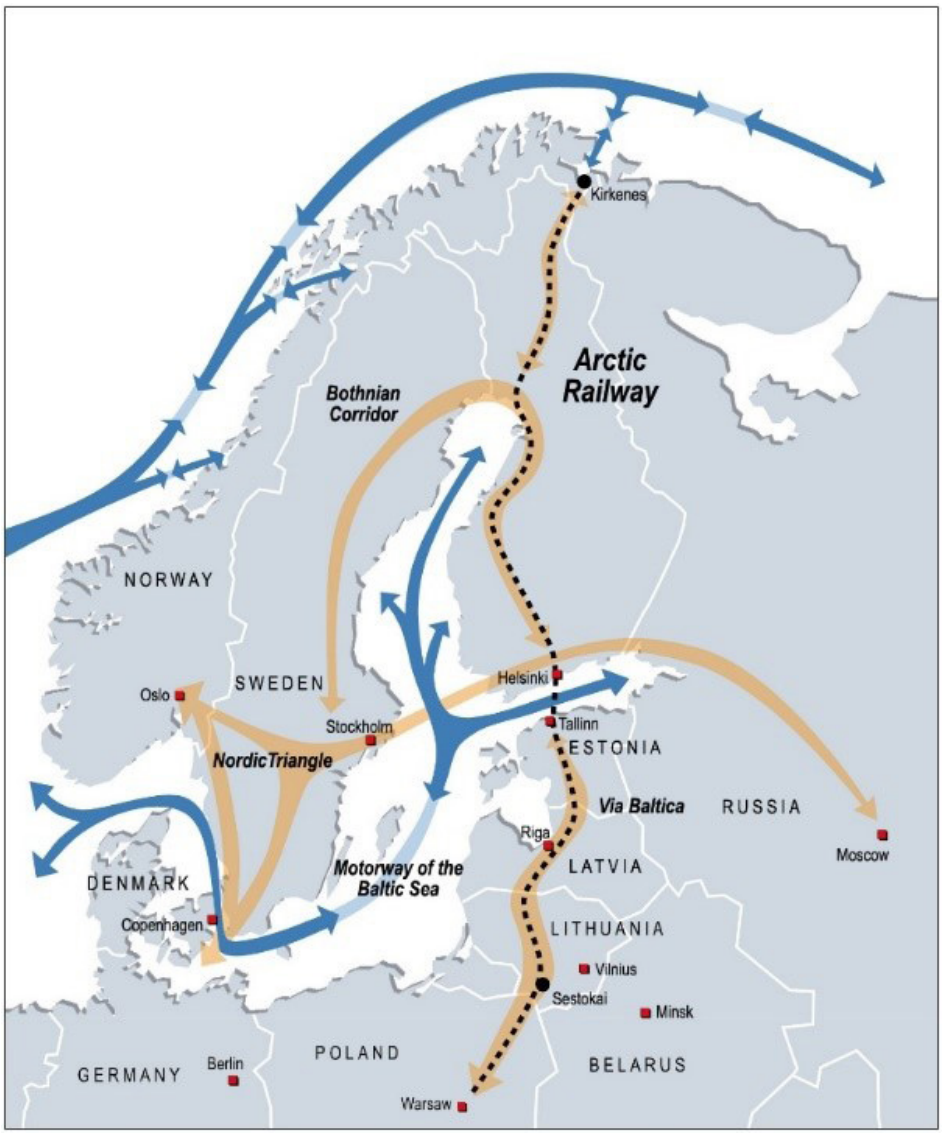
Iceland was the first European country to sign a free trade agreement with China in 2013 after six years of negotiations. In 2014, Orkustofnun, the Icelandic National Energy Authority granted a license for exploration and production of oil resources in Iceland continental shelf to a joint venture led by China National Offshore Oil Company (60%), Eykon Energy (15%), and Norwegian state oil company Petoro Iceland (25%).

China-Iceland initiatives also include scientific cooperation such as the creation of the China-Iceland Joint Aurora Observatory in Iceland with the Polar Research Institute of China (PRC).

In Finland, China's Sunshine Kaidi New Energy Group is planning an investment of some 1 billion euros in a new biodiesel plant in the city of Kemi in Northern Finland. Sunshine Kaidi is one of the largest Chinese private company in biomass power generation, operating already about 30 biomass plants in China and Vietnam. The investment, contributing to the local employment and economic development is more than welcome by regional and national authorities.

In 2017 Finnish and Norwegian transport authorities agreed to a joint assessment and preliminary planning of the "Arctic Corridor", a €3 billion railways line connecting the city of Rovaniemi in northern Finland with the Norwegian port of Kirkenes on the Barents Sea. China is a potential partner for such project connecting China to Northern Europe either through the Arctic Ocean deep-water ports or through Russian Railways (Map 5).

Map 5 The Arctic Railways Project



Source: Arctic Corridor

5. Challenges and Opportunities

China's investments in the BSR raise a series of question marks regarding international trade, the international decision-making process, the sustainability of large projects, managerial capabilities, and cooperation in innovation-driven sectors.

China-BSR trade

The trade deficit with China is a major preoccupation at the pan-European level: only Germany and Finland have a reasonably balanced trade with China. The recognition of the "market economy status" of China is subject to a decision of the EU Commission under a qualified majority vote, and countries like Greece, Hungary, Spain, and Italy, seeking to attract Belt and Road potential investments, could favor this decision, while other countries could hesitate, and others will say no.

In the BSR, attracting Chinese FDI and developing exports to China should be closely connected, and a special attention should be given by institutions of the BSR and their Chinese counterpart to helping especially small and medium-size companies to have a better access to the Chinese market.

The international decision-making process

China's entry in the Baltic Sea Region is characterized by a full alignment of Chinese government policy, state-owned enterprises strategic moves, and project financing by Chinese-led funds or institutions. On the Chinese side, there is one vision of national priorities and business interests, even if the implementation at the corporate level is pragmatic and flexible, open to new initiatives and alternative options.

The same convergence does not exist in the Baltic Sea region where national and regional interests are pushing in different directions, for example in the case of transport policy. The need for a coordinated corridor approach to managing the international trade flows between the Baltic Sea region and China along the Eurasian land-bridge is clearly identified by the EU Commission. However, there is still a discrepancy between the long-term EU Trans-European Transport Network policy and China's initiatives and rapid moves.

The sustainability of large projects

Large infrastructure, energy, and mining projects have a major impact on the social, economic, and ecological environment. The three overall objectives of the EU Strategy for the Baltic Sea Region are to 'Save the Sea', 'Connect the Region' and 'Increase Prosperity'. It means that the institutions and companies involved in large Sino-foreign projects conducted in the BSR and the Arctic have a major responsibility towards society and the environment. This obligation is also an opportunity for companies to operate at the most advanced international standards of sustainable development in the BSR and in China.

Managerial capabilities in Sino-foreign projects

The success of Chinese investments and Sino-foreign projects, in terms of sustainability, financial performance, delays in execution, and quality of services is ultimately linked to the expertise and talent of the management teams. Thus, Chinese companies and their business partners in the BSR have to further develop their capabilities in terms of cross-cultural management and collaborative strategies with local institutions, business partners, and workforce.

Cooperation in innovation-driven sectors

Cooperation with Chinese firms in the high-tech sector is a great opportunity for both large companies and small and medium enterprises of the BSR embarked on innovation-driven strategies. China's open-door policy had to do in the past in opening the Chinese market to foreign firms in exchange for technology. In this new phase of Chinese investments in Europe and the BSR, a similar opportunity is born in terms of co-innovation.

Chinese firms have the interest and capacity to co-invest in innovative projects in renewable energy, digital connectivity, or the bio-medical sector offering the possibility to startups and innovative SMEs to grow faster and to develop an early presence in China and third countries market.

Conclusion

China's investments in Europe and the BSR will continue to grow in the future. In 2017 China's State Council issued new regulations on overseas deals by Chinese companies imposing explicit restrictions on acquisitions in sectors such as real estate, hotel, and entertainment. But the new rules also confirm the government support to projects linked to the Belt and Road Initiative, exporting China's technology and equipment, upgrading China's capabilities in research and manufacturing, and serving the needs of China in terms of energy and resources.

China's investments in Northern Europe and the BSR have already a marked influence on the port activities, shipping and maritime industry, construction, railways and logistics, manufacturing, telecom, energy, and natural resources sectors. China's Belt and Road initiative and the Sino-Russian economic rapprochement open new perspectives to BSR countries in terms of transport connectivity and trade with Eastern Europe, Central Asia, and China.

Germany is particularly well placed to benefit from the development of China-Europe trade and Chinese investment in Northern Europe, but the cities and regions of the BSR which can further improve the connectivity between their seaports, railway networks, and the European core markets can also increase significantly their long-term comparative advantage.

China and BSR countries share common goals in terms of innovation policy, which opens the way to research collaboration in priority areas for a sustainable economic development in the Baltic Sea region such as climate change, clean energy, clean shipping, networked and efficient logistics clusters, sustainable forest management and exploitation of marine resources.

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