An explanation for the Chinese interest in investing in the new EU Member States. A fixed effects panel data analysis

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Abstract
The present study deals with FDI determinants in the new EU Member States from Central and Eastern Europe from investment flows originating from China. The bounds between China and the CEE region were enhanced in 2011, once with the announcement, in Budapest, of the 16+1 framework of cooperation and its entering into force in 2012, while the launch of the One Belt One Road Initiative is meant to further strengthening the cooperation with the CEE countries. The study is investigating the special theoretical framework for explaining Chinese FDI outflows and for establishing the corresponding main FDI determinants. The empirical part is focused on building six panel models with fixed effects encompassing five CEE countries (Bulgaria, the Czech Republic, Hungary, Poland and Romania) for testing FDI determinants and the main motivations of investors from China during the period 2005-2015. Our main results confirm that the dimension of the market has the strongest impact on attracting FDI from China. In addition, Chinese investors are also targeting a certain type of strategic resource – the qualified labor force, which enable them to gain practical information and skills – and are looking for efficiency-seeking locations.
Keywords: foreign direct investment, new EU Member States, China, market-seeking investments

Introduction

People's Republic of China (from now on China) emerged as an important source of foreign direct investments (FDI) in last years. The literature is abundant in studies for empirically finding the determinants of Chinese outflows of FDI and points to several characteristics that make Chinese FDI special: their home country, which is an emerging one, as compared to the usually developed countries of origin for MNE's; the carriers of the investments – large state-owned enterprises or small private companies; their

different motivations and conditions under which the internationalization initiative is taken. The lack of data made the empirical studies testing the emerging markets' location determinants of FDI in the Central and Eastern European (CEE) countries generally unavailable. However, in the last period, once with Chinese initiatives in the region, the investments started to flow in a more stable manner, which allows us an empirical analysis meant to cover the gap in the literature.

The accelerated expansion of outward Chinese investment was enhanced by the "Go Global" policy, launched in 1999 (Buckley et al., 2007; Simurina, 2016), through a strategy under the coordination of the government. The pace of China's internationalization through outward investments was further energized by the approval for private companies to invest abroad, starting with 2003 (Buckley et al., 2007). Still, main Chinese investors are state-owned enterprises (SOE), under the supervision of central of provincial governments.

The bounds between China and the CEE region were enhanced in 2011, once with the announcement, in Budapest, of the 16+1 framework of cooperation and its entering into force in 2012. This format allowed for annual summits and cooperation in the areas of finance, infrastructure, culture and education, economy and investments (Goralczyk, 2017). Afterwards, the One Belt One Road (OBOR) Initiative was launched, further strengthening the cooperation with China in the CEE region. The strategy is meant to be implemented in the same time with the 16+1 framework. Although the EU is not keen on responding to this strategy and the CEE countries still confront political uncertainty related to the subject, they tend to be interested in developing their connections with China (Goralczyk, 2017).

Notwithstanding the Chinese outward FDI saw an important surge in the last years in the CEE region, Chinese capital is still at low levels (under 1% of each country's GDP, except for Hungary, according to McCaleb and Szunomar, 2017; Jacoby, 2014). Jacoby (2014) accounts for a strong heterogeneity of Chinese investments in these countries, pointing to the strong lead of Hungary in both the volume of investments' stock and the important increase in FDI from China, while neither the largest country (Poland), neither the richest (the Czech Republic) do not have important stocks and other new EU member state (like Slovakia and Lithuania) do not have Chinese FDI at all. McCaleb and Szunomar (2017) puts the differences of Chinese investment distribution on behalf of the Chinese diaspora in these countries and the quality of political relations. A substantial leap in Chinese OFDI in the ten new EU member states could be noticed starting with 2010, when Hungary saw a strong increase of FDI inflows from China. In the following years, Hungary took the lead of these countries as regards FDI stocks (see Figure 1),

establishing a steady pace of Chinese FDI inflows, to which joined the rest of the CEE countries. The FDI stocks coming from China increased by almost 29 times, from 65.8 million USD in 2005 to 1897.61 million USD in 2015 in the CEE region. The largest part of Chinese FDI stocks in the new EU member states are cumulated in five countries: Bulgaria, the Czech Republic, Hungary, Poland and Romania. These countries' stake in Chinese FDI stocks increased from 89.7% of total Chinese FDI stocks in CEE countries in 2005 to 92.1% in 2015, with a maximum of 96.8% in 2010.

McCaleb and Szunomar (2017) explains that the CEE countries were not that interesting for the Chinese investors until 2005-2007 who, at that time, tried to access the larger market of the EU. After that, the interest in this region increased, motivated by both EU adhesion and the low labour costs. In addition, it was only after the economic crisis in 2008 that these countries started to look for other sources of investments, like China, and developed strategies or favourable measures in this area. At present, one of the main obstacles encountered by the Chinese investors when locating in the EU is the need to comply with the regulations of both the European block (Jakobovski, 2015) and of the host country, which could appear as an odd economic construct, where the institutional framework is unclear (Ebbers and Zhang, 2010). Ebbers and Zhang (2010) also points to the low level of Chinese investments in Europe even as compared to Asia, Africa and Latin America.

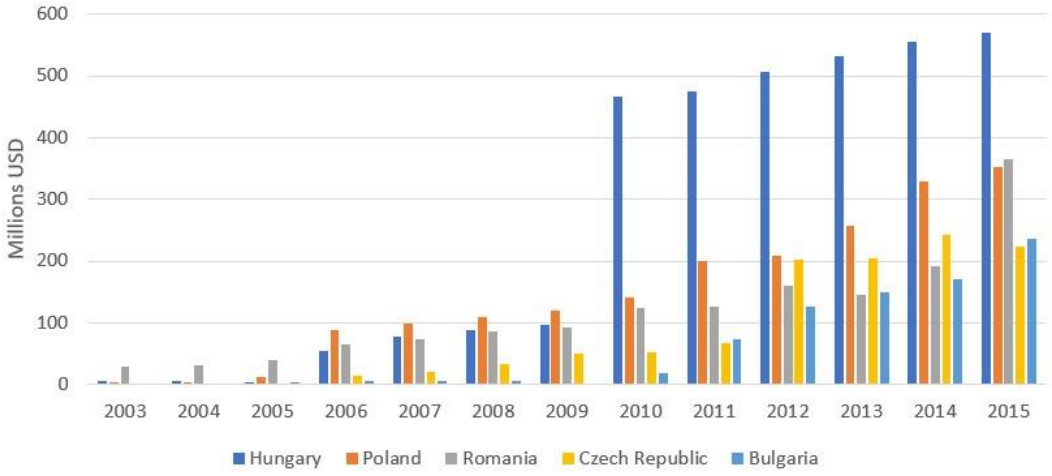

Figure 1. Evolution of Chinese OFDI stocks in CEE countries

In this context, the aim of this paper is to establish FDI determinants of Chinese outflows in CEE countries and to identify the main motivations for investing in these countries. Our paper is organized as follows: in the next section, we briefly present the

FDI theory as shaped by the specific characteristics of Chinese outward FDI. The following part introduces the data and methodology, while in the subsequent section we present the results in comparison with the outcomes of other similar studies focused on emerging economies as host countries. The main findings are provided in the Conclusion section.

Literature review

Due to the fact that FDI are generally associated with positive spillovers in the host economy, having a significant impact on the economic growth and development (Borensztein et al., 1995; Dunning, 1993 etc.), the literature is particularly concerned in identifying the factors that generate FDI flows. The internationalization of production continues to be theoretically best explained by three advantages: ownership (O), location (L) and internalization (I), which describe the framework of the eclectic paradigm proposed by John H. Dunning (Dunning 1980, 1988). The ownership (O) advantage refers to both tangible assets of the firm, such as its natural resources, labour, available capital, and intangible assets: technology and information, managerial and entrepreneurial skills, organizational systems, patents and brand reputation. The internalization (I) advantage depends on the firm's ability to produce and market its assets through its subsidiary network. The location (L) advantage relies in the differences between the host and the home countries in terms of endowment with factors, the structure of the market, the political, cultural and legal environment, etc.

Still, when the investment relationship unfolding on the axis home-host country is between two emerging markets, the literature points to different behavior of the multinational enterprises (MNE) and various FDI determinants. General theory of FDI cannot automatically be applied to emerging economies, as FDI theory was originally designed for developed countries (Buckley et al., 2007), first for FDI outflows and only later for FDI inflows. On the contrary, emerging countries were originally considered host countries for FDI and later on potential FDI sources (Vasyechko, 2012). This is also the case for China, which was one of the main recipients of FDI inflows until 2014, when became a net exporter of FDI. Related to the emerging markets, there are different characteristic as compared to the advanced countries in either position they would be – as a home or a host country.

As a home country, the state support provided for the internationalization of the domestic companies is higher than in the case of developed countries, as pointed earlier. Buckley et al. (2007) resume the main changes imposed by the specific situation of China

in three major alterations of the theory, related to the institutional factors affecting Chinese outward FDI, the ownership advantage and the capital market imperfections.

The institutional factors in the home country are considered relevant in shaping the investment decision – starting with its initiation, up to its "amount, direction, and scope" (Buckley et al., 2007, p. 10) and strongly theorized by Yan et al. (2018) on the example of China. In this way, the government control is considered to have strongly influenced the internationalization decision of companies. Its mark is noticed in the support granted to FDI in several specific sectors since 1980 until present. It is widely recognized the interest of FDI in natural-resource endowed locations, in further promoting exports and in channeling investments in advanced sectors, as Child and Rodrigues (2005) emphasize. The method of conducting the economic development – by central planning – is still having a large impact on the activity of the external sector. Zhang and Daly (2011) and Cheung and Qian (2009) admit this system, of interference of authorities in guiding outward FDI for accomplishing their plans in terms of objectives and location. The review of Deng (2012) also points to the fact that such aspect is largely addressed in the literature. On the other side, the constraints – such as too restrictive conditions and their implications for the companies' profit and development and lack of autonomy, to which uncertainty and complexity of the legal system is added – raised by central and provincial governments – could be a reason for investing abroad, as attested by Child and Rodrigues (2005).

The ownership advantage is, in this case, superior to other similar companies from other states due to the dependence on the state resources. The consequence is that the strength of the company lies in the strength of its state. Moreover, MNEs are more prone to pursue the interests of the state than the usual interest of profit maximizing. Therefore, investments in riskier locations are not unusual. The internationalization process of companies from emerging markets is different than in other countries (Jindra et al., 2015). A characteristic of Chinese outward FDI is the "carrier" of such investments, namely the state-owned enterprises (SOE). Cui and Jiang (2012), in defining this special type of enterprise, consider them as assets of the home-country governments, or "political actors", that rather pursue the interests of the home-country than of their own. The government support not only provide resources to the company – usually for compensating for their lack of advantages when investing abroad – but also influence their strategic choices, which could distort their risk perception. Their specific advantage in this case makes them stronger on the market, increasing their resistance to losses. Secondly, being backed by important financial resources, their strategy is to acquire

companies that are already either known in the market, either endowed with strategic or natural resources, rather than developing a greenfield investment (Jakobovski, 2015). This strategy is seen more profitable for the foreign part (which, in this way, could accelerate the development of its competitive advantage) than for the host country. Therefore, such companies have the advantage of being familiar with the distinctive environment of the emerging economy, have experience in being flexible and in economizing resources and capital and rely on the network of relationship developed with other important actors on the market (Buckley et al., 2007).

Related to the capital market imperfections, Buckley et al. (2007) identify a special situation of capital being available at below market rates, which could be transformed into strong ownership advantage. This happens due to the extensive presence of SOEs who benefit from government support, an inefficient banking system favorable to outward investors, the inefficiency of the internal capital market which leads to subsidizing FDI and capital provided by family members to family-owned companies.

As a host country, emerging markets are confronting different types of problems that make them more inaccessible than developed countries. On one hand, the sustainability of the economic growth should be carefully assessed; the macroeconomic stability could be under pressure; the quality of institutions is under construction, as bureaucracy and corruption are still major problems, both economic and political environments are unstable and hence the higher degree of uncertainty that results in potential risk to the business. Emerging markets require strong investments for the development of their infrastructure or for developing their technological and research and development (R&D) basis. On the other hand, their opportunities and advantages lie in the access to low cost and highly qualified labor, natural resources or large markets.

All these characteristics determine different interests of MNEs from emerging markets in the location decision-making process. Duanmu (2012) checks for such different approaches in tackling markets depending on their development level. While the author does not find sufficient evidence for distinguishing between the strategical intents of the Chinese MNE according to the type of market (developed or developing), Buckley et al. (2007) emphasized a contrary result, Chinese outward FDI being more oriented towards less-developed and risker host countries than to developed host countries. Duanmu and Guney (2009) find that, when targeting another emerging market, the interest is in taking advantage of its resources or the dimension of the market. Different motives when investing in Europe are also certified by Dreger et al. (2017), who consider that Chinese investment in Western Europe are dedicated to seeking for

advanced technology and recognition (through acquisition of brands), while those in CEE region are made for establishing a platform for entering the EU.

Data and methodology

The purpose of our investigation is to establish FDI determinants of Chinese outflows in the CEE countries. Due to data constraints, our analysis is carried out on a sample of five countries in the CEE region, members of the EU and the largest Chinese investments' receivers in the last years (Bulgaria, the Czech Republic, Hungary, Poland and Romania). The empirical analysis is carried out for the 2003-2015 period. This justifies us to employ a panel data analysis, which has the advantage of multidimensionality.

Table 1 presents the variables used and the data sources. The dependent variable is China's outward FDI stocks to the five host countries in the CEE region. Our variables also allow identifying the major motivations of Chinese investors when deciding to invest in this region: market (GDP), resource (RES), efficiency (LROAD, NULC, ITRL, COR) or strategic asset seeking (LRSH, DPATENT). The descriptive statistics and correlation matrix are presented in Table 2.

Table 1. Variables used in the empirical analysis

Variables	Explanation	Data source
LFDI	Logarithm of China's outward FDI stocks to host countries, million USD	MOFCOM
LGDP	Logarithm of GDP at PPP, constant 2011 international USD	World Bank
RES	Host countries exports of raw materials, mineral fuels, lubricants and related materials, percentage of total exports	EUROSTAT
COR	Control of corruption, score from -2.5 to 2.5	World Bank Governance Indicators
DPATENT	First difference of number of patent application for residents.	World Bank
LRSH	Logarithm of the number of researchers in R&D per million people	World Bank
ITRL	Implicit tax rate on labour, %	European Commission
NULC	Nominal unit labour cost based on hours work, Index, 2010=100	EUROSTAT
LROAD	Logarithm of kilometres of motorways	EUROSTAT

DUM	Dummy variable; takes value 1 if the country is an EU Member State and 0 otherwise

Source: Author's computations

Table 2. Descriptive statistics and correlation matrix

	COR	DPATENT	ITRL	LFDI	LGDP	LROAD	LRSH	NULC	RES
COR	1								
DPATENT	0.205534	1							
ITRL	0.651125	-0.12672	1						
LFDI	-0.00536	0.14723	-0.0513	1					
LGDP	0.447474	0.349047	0.082223	0.37391	1				
LROAD	0.611062	0.13647	0.452109	0.566712	0.311929	1			
LRSH	0.53656	0.03285	0.513452	0.19796	-0.00364	0.633276	1		
NULC	0.1738	0.133995	-0.00435	0.585297	0.139361	0.671936	0.52844	1	
RES	-0.81977	-0.11694	-0.8047	-0.12614	-0.5737	-0.53173	-0.41355	-0.08984	1
Mean	0.19379	39.51563	34.18691	3.857137	26.38234	6.473261	7.42393	93.56094	10.27376
SD	0.32598	187.666	5.692231	1.934526	0.661595	0.544558	0.382917	13.44224	6.290405

Source: Author's computations

Results and discussion

The results section is the most important part of the abstract and nothing should compromise its range and quality. The results section should contain as much detail about the findings.

We find that market-seeking is one of the strongest motivations of Chinese investors in the CEE countries (Table 3). The GDP variable is significant in attracting FDI and remains significant in all models, except for Model 3. In this respect, our study is in line with Quer et al. (2017), Zhand and Daly (2011), Kolstad and Wiig (2009), Buckley et al. (2007) etc. Interestingly, the dummy variable responsible for indicating if a country is an EU member state or not has a negative and significant impact on Chinese FDI in models 1 and 2. In model 3, if we add the DUM variable, the Adjusted R-squared is lower; in addition, once the LRSH variable is added, the EU adhesion is no longer significant for

attracting FDI from China. The literature does not provide other empirical results supporting the impact of EU adhesion on Chinese investors. However, according to the theory, it is frequently noted that Chinese' interests in the CEE countries are led by the accession to the larger market of the EU (McCaleb and Szunomar, 2017). In our case, it seems that this assumption is not true. Our result would be rather framed in the literature pointing to the difficulties encountered by the Chinese investors when locating in the EU (Jakobovski, 2015), such as the need to comply with the regulations of both the European block and of the host country, which could appear as an odd economic construct, where the institutional framework is unclear (Ebbers and Zhang, 2010). McCaleb and Szunomar (2017) consider that Chinese investments are rather distributed on behalf of the quality of political relations in the CEE countries.

From a resource-seeking perspective, the coefficient of LRES is significant and with the positive expected sign in two out of the three models where it is used, pointing the aim of foreign Chinese investors in these countries for resources. A similar behaviour is supported by Quer et al. (2017) and Ramasamy et al. (2012), who identify a positive relationship with the outward FDI from China. Instead, Duanmu and Guney (2009), Kolstad and Wiig (2009), Duanmu (2012) or Zhang and Daly (2011) point to a lack of significance for resource endowed locations. The explanation could be the one provided by Buckley et al. (2007), who state that China ensured its needs of economic growth by accessing countries providing raw materials in early periods and is reorienting towards strategic asset-seeking. In fact, the coefficient of RES turns insignificant once we add LRSH in our model (Model 6), pointing to the importance of researchers for the foreign investors. In fact, the variable proves to be even more important than the dimension of the market and the degree of political risk (Model 3), as the coefficients of these variables become insignificant once LRSH is added.

Moreover, the NULC variable becomes significant, but with a positive sign, contrary to expectations; in fact, this suggests that Chinese investors are determined to take advantage of the highly-skilled labor forced (expressed through the number of researchers), even if the labor cost is higher. The other variable expressing the strategic asset-seeking motivation, the number of patents (DPATENT) is not significant in attracting FDI, although it generally has the expected positive sign (except for model 5). Our result confirms the previous findings in the literature that the search for strategic assets is a later motivation of Chinese investors (Buckley et al., 2007) and that Chinese investors are attracted rather by the presence of qualified labor force than the existence of advanced technology (Gammeltoft and Fasshauer, 2017). Ramasamy et al. (2012) find a positive and significant relationship between host country's exports of high technology

products and FDI projects, but a negative one as regards the number of patents. The authors explain these results by pointing the interest of China for countries where core research (approximated by the number of patents) could be translated into practical knowledge and products, thus emphasizing the pragmatism of the Chinese companies.

Given that the main interest in the category efficiency seeking motivations is related to cost and China has a competitive advantage at the labor cost, Buckley et al. (2007) consider that such type of motivations for Chinese investors are less likely. Still, our results point that Chinese investors in the CEE countries grant a high importance to this type of motivation, as the proxies used for this category are significant and usually with the expected sign. The variable related to the dimension of the road transport infrastructure is positive and significant in attracting Chinese FDI in each of the six models, and the results are robust even when the LRSH variable is added to the model (Models 3 and 6). Although studies checking for the impact of infrastructure on FDI are numerous, they usually do not regard the MNE from emerging markets. Li et al. (2018) conclude that countries with high quality of infrastructure, in general, are more attractive for foreign investors, even for those originating in emerging countries.

The NULC variable is also an indicator of efficiency-seeking motivation, as it expresses the ratio between the labor costs and productivity. Therefore, the expected relationship between NULC and FDI is a negative one, as a higher value of NULC would point to lower productivity related to costs. We obtain a positive impact of NULC on Chinese outward FDI which, correlated with ITRL, which mainly represents the "average effective tax burden on labor income", could suggest a more interest for the quality of the labor market, than for the taxation level. ITRL is significant only in Model 1 and keeps the negative sign in all three models.

The corruption level has a negative and significant impact on Chinese FDI stocks in CEE countries, pointing that foreign investors are attracted by environments with low levels of risk. Our result is in accordance with Dunamu and Guney (2009), who find that the lower the risk, the higher the volume of attracted FDI in host locations. Usually, the literature emphasizes the tendency of Chinese foreign investors to locate in areas with a high level of risk. Buckley et al. (2007) explains this behavior by other motives tracked by the Chinese companies than the profit (as they are following the government aims). Gammeltoft and Fasshauer (2017) consider that, as latecomers, Chinese investors must settle in the remaining available locations, namely those endowed with a high level of risk. The risk tolerance is higher for Chinese companies, as the requirements of accountability and transparency are not as harsh as those in developed locations and the operating environments are similar. Finally, Chinese investors take the risk of weak

institutions that is usual for locations with a rich endowment in natural resources. Our result is rather in line with Ramasamy et al. (2012), who state that in the less risky countries, Chinese investors (especially SOEs) search for technology or strategic assets.

The results for the redundancy of the fixed effects estimates support the choice of our models, and the significance at 1% of the F-test statistics indicate that regressions models fit well the data (Table 3).

Table 3. Determinants of Chinese outward FDI in the CEE countries

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
LGDP	9.664987*	9.613898*	3.079501	5.607909*	6.240558**	3.158666***
	3.87568	3.720235	1.501531	2.728005	2.559185	1.873637
COR	-4.23742*	-4.25548*	-0.58507			
	-3.95196	-3.88685	-0.55311			
RES				0.167916**	0.136957***	0.047109
				2.512569	1.923988	0.868302
LROAD	2.047468*	1.965643*	1.540775**	2.119347*	1.644503**	0.835355***
	3.723922	2.775015	2.46464	3.811252	2.542017	1.696886
ITRL	-0.10998***	-0.10101	-0.09101			
	-1.86534	-1.39512	-1.45167			
NULC		0.004135	0.009581		0.028703	0.022545***
		0.212642	0.57753		1.452957	1.680919
DPATENT		0.000165	0.00037		-0.00061	0.00011
		0.245925	0.625298		-0.78623	0.189504

LRSH			4.406403*			5.26969*
			4.595384			6.818051
DUM	-1.1211**	-1.15579**			-0.59518	
	-2.30325	-2.17122			-1.01232	
C	-258.855*	-257.645*	-117.76**	-159.49*	-174.955*	-126.527*
	-4.0482	-3.88615	-2.33384	-3.10895	-2.82978	-3.01723
R-squared	0.829185	0.829534	0.867777	0.72241	0.736236	0.855566
Adjusted R-squared	0.800716	0.793474	0.839807	0.688319	0.687391	0.828819
S.E. of regression	0.863595	0.879148	0.774278	1.072026	1.073621	0.794471
F-statistic	29.12582*	23.00421*	31.02495*	21.19121*	15.07284*	31.98734*
Redundant Fixed Effects Tests						
Cross-section F	12.79383*	11.88761*	19.06756*	13.81738*	12.45326*	33.76414*
Cross-section Chi-square	42.66526*	41.56291*	57.78531*	44.06032*	42.48449*	81.44904*

Note: *, ** and *** denote 1%, 5% and 10% significance levels, respectively. The values in the parenthesis are the t-statistics values.

Source: Author's computations

Conclusions

The research objective of this paper was to establish FDI determinants of Chinese outflows in CEE countries. The main contribution to the literature resides in enlarging the knowledge related to determinants of FDI having China as home country. To our knowledge, this is the first study focused on the five CEE countries members of the EU, which have also a special place in the FDI literature due to their unique situation in building the appropriate institutional infrastructure for the market economy.

Our theoretical framework starts from the traditional theory presenting the main factors taken into account in the internationalization process and allocate a significant part for understanding the behavior of the Chinese investors and the drivers of Chinese outward FDI. This investigation is useful for building an empirical model that

encompasses the main features of the potential interests of these investor in the CEE region.

The empirical model is built for the period 2003-2015 and includes five CEE countries (Bulgaria, the Czech Republic, Hungary, Poland and Romania). The results of our study confirms that market-seeking motivation is the main factor for attracting Chinese FDI but, contrary to the expectations formulated in the literature, this is not because these countries provide them an easier access to the larger market of the EU. It would be rather the consequence of qualified labor force, which is available at low costs. We could notice that a large part of the significant coefficients belongs to the variables shaping the labor market. Therefore, we could state that market-seeking and labor market determinants are the most important factors in attracting Chinese FDI in the CEE countries. In this context, the search for resource endowments is significant only when the models do not include the presence of qualified labor force (which is included in the category of strategic assets). Finally, we fill a gap in the literature related to the less investigated subject of efficiency-seeking motivations. Our findings point to the high importance granted by Chinese investors to the road infrastructure, the low level of labor taxation and environments with low corruption.

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