

The China Phenomena in the Baltic Sea Region

by Kari Liuhto

China has received a lot of attention from foreign investors due to the huge potential of its market, low production costs and the high growth rates of its economy. Due to the aforementioned reasons, foreign direct investment (FDI) flows to China are impressive. Whilst admiring China's performance, one should not forget that that growth rates related to FDI are also considerable in the Baltic Sea region (BSR).

In fact, the Baltic Sea region's FDI growth is even higher than that of China in the past ten years, and particularly faster during the past 5 years. In the period 1995-2004, China's inward FDI stock more than doubled. During 2000-2004, it grew by 8% only. During the past 10 years, the inward FDI stock of the Baltic Sea region more than tripled. During this decade, it has grown by 57%, indicating much faster growth than in China. In terms of FDI inward stock per capita, the BSR would clearly outperform China.

Even if the FDI growth rates flatter the Baltic Sea region, one should not get too excited over them since a major part of the investment flows in the region are internal ones. In other words, the nine countries surrounding the Baltic Sea region invest in each other. For example, some 60-80% of all FDI in the Baltic States and Finland originates from another BSR country. Though the figure in Denmark, Poland and Sweden is considerably lower, it is still around 25%. Russia receives approximately 10% of all its FDI from the BSR and Germany 5%. Investment flows in the region result mainly from capital flows from the west of the region to the east (see BRE 2/2005).

As a great part of the FDI flows is due to intra Baltic investments, the region as a whole does not receive new capital but the capital only moves from one shore to another. Therefore, the China phenomenon in terms of high FDI growth rates in the Baltic Sea region is, to a great extent, a statistical bubble. In order to change the situation for the better, a common investment promotion agency and strategy for the whole region should be constructed.

Development of FDI inward stock (USD billion)

	1995	2000	2004	Multiplier	
				1995-2004	2000-2004
Denmark	23.8	73.6	98.2	4.13	1.33
Estonia	0.7	2.6	9.5	13.57	3.65
Finland	8.5	24.3	55.9	6.58	2.30
Germany	192.9	271.6	348.0	1.80	1.28
Latvia	0.6	2.1	4.5	7.50	2.14
Lithuania	0.4	2.3	6.4	16.00	2.78
Poland	7.8	34.2	61.4	7.87	1.80
Russia	5.5	32.2	98.4	17.89	3.06
Sweden	31.1	94.0	163.0	5.24	1.73
BSR-9	271.3	536.9	845.3	3.12	1.57
China	311.5	651.6	706.5	2.27	1.08

Sources: World Investment Report 2002 & 2005, UNCTAD

If the China phenomenon related to the FDI growth in the BSR is a statistical bubble, one should not forget that the China phenomenon takes place in the region in another form. In other words, economic relations with China are growing rapidly, imports in particular. In 2004, China accounted for some 3-7% of imports of all the BSR countries, excluding the three Baltic States, where the China accounted just 2% of their imports.

The relative importance of the BSR countries' exports to China is rather modest. Due to Russia's geographical location it is natural that China forms a substantial part (7%) of its exports. However in other BSR countries, China accounts for, on average, less than 2% of these countries' exports.

As investments have a tendency to follow export flows, some Chinese companies have already invested in the Baltic Sea region. Although China is statistically a minor player in the region, two Chinese investments in the region deserve special attention.

The construction project called the "Baltic Pearl" in the St. Petersburg region is China's biggest investment project in Russia and probably the largest project of the Chinese companies in the Baltic Sea region. According to this investment plan, a group of half a dozen Chinese firms aim at investing USD 1,25 billion to build a 180-hectare residential district in the City of St. Petersburg. The first part of the Baltic Pearl should be finished in 2008.

Huawei Technologies present another type of Chinese investment in the Baltic Sea region. In 2002, the company founded its R&D unit in Sweden. This Chinese telecom giant aims at harnessing Swedish expertise in Internet telephony and third-generation cellular technology. Obviously, the goal of Huawei Technologies is not to set up production in Sweden but to carry out R&D work there and bring the results of this knowledge to the use of its parent company.

To conclude, Chinese investments in the Baltic Sea region is still a rarity but probably in the future the presence of the Chinese firms will grow along with the accumulation of capital in China, which pushes its firms abroad to acquire fresh management skills and advanced technologies.

In my opinion, the companies of the Baltic Sea region should already prepare for this novel phenomenon though it is still unlikely that the presence of Chinese investments in the Baltic Sea region would grow as fast as the presence of the Russian firms. Despite a slower expansion, a thorough study concerning the business entry of Chinese corporations in the region should be carried out sooner rather than later. Such research might aid policymakers in anticipating the possible consequences of the Chinese business entry to the BSR.

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