INFLOW OF CHINESE INVESTMENT TO THE CZECH BUSINESS ENVIRONMENT

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Abstract: The purpose of establishing a strategic partnership between the Czech Republic and the People's Republic of China was to increase investment activity between countries. The aim of the paper is to map the main Chinese capital holders and their investment activities that were boosted by the Czech system of investment incentives. The investigation is based on data from Czech National Bank and Czech national agency CzechInvest using case study approach. In the period 1993 - 2017, the investment amounted for 6.67 billion CZK. It counts for 29% of all Chinese investment representing supported projects by the Czech system of investment incentives. The rest two thirds of Chinese capital goes to core Czech regions.

Keywords: Capital inflow, Chinese capital, Czech economy, foreign direct investment, investment incentives, multinational companies.

1 Supporting foreign capital inflow – yes or no?

The inflow of foreign capital has been a controversial topic in economic literature. The reason is its huge range of created effects that some of them are positive and some have the negative consequences. Nevertheless, the foreign capital is interpreted mainly in the positive way. The reason for this is that the positive effects tend to come to light and emerge immediately (creation of new jobs positions, improved payment balance), while negative ones often occur in the longer term (taking over skilled workers from local companies) and often do not have a clearly specified link to foreign investors (Hořejší, 2015). A typical case is the creation of so-called crowding-out effect where local companies are pushed (crowd) out of the market by the existence of capital-intensive and mainly technologically stronger economic entities (Zamrazilová, 2007). Paradoxically, the local competition may not be liquidated by the investor's targeted efforts. Foreign presence is sufficient due to the significant size of the technological gap between foreign investors and existing local businesses. Expert studies can hardly quantify this phenomenon, as it is difficult to determine (let alone quantify or generally quantify) whether a local company (companies) or industry has disappeared (is in decline) due to the foreign presence of investors in the local business environment. These effects are very difficult to quantify due to their externalities character (Benáček, 2000) and scientific literature is therefore forced to ignore them and focus on more quantifiable indicators. However, these indicators are associated with a short period (financial resources related to employee education) or interpret the localization itself (the size of the investment, the promised number of jobs). These effects have logically positive character.

Comprehensive evaluation of how foreign companies influence the local business environment is very complicated due to the absence of methodology how to complex evaluate the overall impact in a long run (Camagni, 2009). This absence does not contribute to resolving the dispute between experts on the support of foreign capital inflows (Damborsky, Wokoun and Krejcova, 2013). The system of investment incentives, which can be requested by both foreign and local companies, causes disproportions on the market. There is an incentive redistribution from small businesses that logically cannot meet investment criteria, towards capital (and as well as technologically) stronger players. However, the final benefit of localization and attracting of these large economic entities is uncertain, resp. not yet quantified. It means that governments spend considerable sums from public sources` resp. from tax revenues from entities that cannot apply for investment incentives. The final impact over a long period of time may be negative or zero for these entities (Minchung et al., 2019). Then, investment incentives become completely counterproductive.

More discussed is the situation when companies from countries with lover economic level gained investment incentives. In this case, the difference between the economic levels of both countries is definitely not negligible (the Czech economy had a higher economic level compared to China in 2017 by USD 11,553) based on GDP per capita in current prices (World Bank, 2019).

It is a case of Chinese investors. The Chinese capital inflow changes the territorial structures of capital inflows to the Czech Republic. In the past, in particular, large investment projects from technologically and economically more advanced countries were supported (Hořejší, 2016).

2 Central Europe: the host market for Chinese investors

In the past decade (from the 2005) Chinese companies have increasingly targeted Central and Eastern European countries. China is especially interested in Czech Republic because of its specific location.

The Czech Republic is one of the most successful Central European countries in attracting Chinese investment, although the amount of Chinese investment in 2012 was not significant. However, the Czech Republic has gradually become one of the largest FDI recipients together with Poland and Hungary, as well as Romania and Bulgaria. At the same time, China is one of the fastest growing investors with potential for further investment in the country. China is gradually changing the structure of its FDI and deviating from investing in natural resources in investing in higher-value technical goods.

Central Europe is well positioned and with stable EU regulatory framework and it has brought opportunities for growth and return on investment (De Castro et al, 2017). The Czech Republic does not benefit only from its geographical location, but also its industrial tradition and good production network with other EU countries. China has played a minor role in this process, but the country's attractiveness is increasing as it is proactively supported politically and lobbying for Chinese business activities (Seaman et al. 2017)

2.1 Current situation of the Chinese investment projects getting the support

There are currenly nine Chinese investment projects that were granted the state aid in form of the incentives. Total amount of these investment is 3.63 bil. CZK (excluding reinvesment projects) and newly created jobs count for 1.565 in total (current status as at March 31, 2019). In all cases, the final decision from Czech government was obtained up to one year after submitting the application. The length of approval process differs among new companies or expansion of existing businesses. Investing sectors of Chinese investors can be seen in the table 1 and description of the companies follows.

Tab. 1: Chinese investment with investment incentives granted by Czech government

Company name	Sector	Type of project	Year of aid granted decision
Changhong Europe Electric s.r.o.	electronics and electrotechnic	Production	2006
SHANGHAI MALING (CZECH) a.s.	food industry	Production	2007
SHANGHAI MALING (CZECH) a.s.	food industry	Production	2008
Solar Express s.r.o.	electronics and electrotechnic	Production	2011
YAPP CZECH	manufacture of	Production	2011

AUTOMOTIVE SYSTEMS Co., s.r.o.	transport equipment		
Lemtech Precision Material (Czech) s.r.o.	metalworking industry	Production	2017
Yanfeng Czech Republic Automotive Interior Systems s.r.o.	manufacture of transport equipment	Production	2017
Espressif Systems (Czech) s.r.o.	IT and software development	strategic service centre - software development centre	2018
XZB (Europe) s.r.o.	manufacture of transport equipment	Production	2019

Source: CzechInvest (2019)

Changhong was established in Mianyang, Sichuan province of China in 1958. The Czech subsidiary started its operation in city of Nymburk in 2006 and it is one of the 43 foreign subsidiaries of the company. The Czech production plant focuses on televisions with LCD monitors. Changhong Europe Electric is currently Changhong's largest overseas manufacturing and operation base. The company has created 300 jobs as promised in their application for the investment incentives from the Czech government and 91 % of its employees are locals. Guided by the "Belt and Road" strategy, based on the manufacturing base in Czech, Changhong Europe Electric has established sales branches in Czech, Germany, France and Italy, and the European marketing center in Germany.

Shanghai Maling were granted with investment incentives for two sequent years in 2007 and 2008. The company operates canned meat production in Teplice which is the region with high unemployment rate and belongs to the most structurally disadvantaged regions of Czech Republic. Starting its history in China at 1930, Shanghai Maling company belongs to Bright Food Group Co. Ltd - state owned shareholding company associating 29 shareholding companies with wide range of activities. It is the biggest food industry company in China at the moment. Only 5 % of the total production capacity of pork luncheon meat and ham was placed on the local Czech market, the rest was exported to other markets in Europe, East Asia and USA. In 2017 the Czech subsidiary went bankrupt after almost two years of continuous problems and it was bought at auction by another Chinese investor. According to press, the company´s problems with debts have roots in the dispute over trademark with China National Cereals, Oils and Foodstuffs Corporation.

Solar Express company specializes in the design and installation of renewable energy systems however there are no public information available about the company.

Yapp Czech Automotive Systems is a part of the YAPP Automotive Systems company with the headquarter in Yangzhou in China since 1990. The Czech plant focusing on fluel tanks for automotive industry is active in Mlada Boleslav since 2010. The location is beneficial due to the local presence of Skoda company, the largest automotive company in Czech Republic. Yapp Czech Automotive Systems supplied Volkswagen with car parts in China since 1988 and this long term cooperation led to establishing the business relationships also in Europe. Thanks to the good partnership with Skoda, Yapp Czech Automotive Systems has been able to expand to Kvasiny, another Czech city where Skoda has its manufacturing plant.

Lemtech Precision Material started its production in industrial zone of Jihlava in 2017. Lemtech comes from Chinese Kunshan and the Jihlava´s plant is the first and only subsidiary in Europe. Lemtech produces metal parts used for electrotechnic and automotive industries, medical devices. Lemtech created about 30 new jobs.

Yanfeng Czech Republic Automotive Interior Systems has two production plants in Czech Republic. Besides its localization in Czech Republic, its European presence is on the markets of Slovakia and Hungary, as other productions plants or technology center and business center. Yanfeng Automotive Interior is a joint venture of Yanfeng Automotive Trim Systems Co and Johnson Controls established in 2015 with a majority share of the Chinese partner and it already has four production plants in Czech Republic. The Czech plant produces instrument panels and cockpit systems, door panels, floor consoles and overhead consoles for automotive industry, namely for example BMW, Daimler, Škoda a Volvo. Thanks to its expansion, the company able to employ much more employees that expected, it plans to create about 1500 new jobs in total which is a great support for the local regional unemployment.

Espressif Systems is one of the newest Chinese investor with state aid on the Czech market headquartered in Shanghai since 2008. This technological company is located in Brno, the second largest city of Czech Republic and boosting as a start-up locality. In order to upgrade its customer services for the European market, it is the first foreign branch of the Espressif company developing advanced power controls, chips, modules, development boards and others that are widely deployed in such products as tablets, OTT-boxes, cameras and IoT gadgets. Althought the number of newly created jobs is not high (nearly 30 jobs promised in the application), there are aimed for skilled labour contrary those in production plants as in other cases.

XZB (Europe) located its investment in the industrial zone Ostrava-Mošnov. The Chinese company was founded in 2002 as Hangzhou XZB Co., LTD and it is a specialist on research and development, manufacture and sales of automotive parts. Except of the headquarter in Hangzhou, Zhejiang province and its European subsidiary in Mošnov, there is also a branch in Mexico. XZB (Europe) plans to create 60 job positions.

In terms of regional localization of the investment, the Chinese investment were located in regions of Central Bohemia (two investment), Usti nad Labem (three investment), Olomouc, Vysocina, South Bohemia, South Moravia and Moravia-Silesia.

3 Subventions of Chinese capital inflows

All the mentioned Chinese FDI are the successful beneficiaries of the Czech system of investment incentives. According to the Czech law and currently regulation by Act No. 72/2000, investment incentives in the Czech Republic are following:

- income tax discount for 10 years,
- transfer of land including related infrastructure at a discounted price,
- 300 000 CZK financial support for the creation of new job position,
- 50 % financial support for retraining or training of employees,
- 10 % financial support for the acquisition of intangible and tangible fixed assets (for strategic investment),
- exemption from real estate tax in preferential industrial zones (i.e. government-approved industrial zones designed to promote balanced and dynamic economic development in the Czech Republic and decreasing the regional disparities).

The most important of the supported projects is the investment project Yanfeng Czech Republic Automotive Interior Systems for both the number of newly created jobs (588) and the size of the investment (1.85 bil. CZK).

Shanghai Maling's reinvestment in 2012 also received investment incentives. However, this support did not prevent bankruptcy in 2017. The contradictions in the effectiveness of granting investment incentives can be perfectly illustrated at this company. Shanghai Maling has invested twice in the Czech Republic, in 2007 and a year later. In both cases, it received investment incentives that were sufficiently motivating to reinvest in the host market. However, in the case of investment support, the result of supporting this reinvestment action is zero. After the period of the investment conditions and criteria run out, the company terminates the operation.

Yapp Czech Automotive Systems is another and the last of these companies that have made a significant reinvestment action on the Czech market. This company reinvested its capital of 246 mil. CZK in 2015 (CzechInvest, 2019).

Based on statistic of Czech National Bank the inflow of Chinese capital decreased at 5.79 bil. CZK in 2015. In 2016, increased rapidly to the level 12.51 bil. CZK. Last current data show that the new capital inflow from China was around 7 bil. CZK in 2017 and the final stock of Chinese investment in 2017 was 23 bil. CZK. (Czech National Bank, 2019).

From the point of view of CzechInvest projects (2019), China was the largest investor in FDI in 2018 in terms of investment and new jobs created. In the period 1993 - 2017, the investment amounted to 6.67 bil. CZK. Resp. 29% of all Chinese investment (including reinvested capital) represents supported projects by the Czech system of investment incentives. The most significant increase could be seen in 2018 (3.7 bil. CZK). Thus, in 2018, China outpaced traditionally active investors from Germany, Japan and Korea. Only Czech companies invested more. The remaining two-thirds of China's investment goes to core regions that are not linked to investment incentives. Due to the aim of investment incentives is to reduce the regional disparities of the core-periphery areas.

In general, investment has grown rapidly following the establishment of a strategic partnership between the Czech and Chinese economy, and although the Czech Republic is going through a period when the unemployment rate is well below NAIRU (Czech Statistical Office, 2019), Chinese investors are still growing. These projects are connected with higher value added than in the past. It means mainly production and development projects, not acquisitions (CzechInvest, 2019).

Although Czech Republic has been attracting increasing number of Chinese investors after strengthening the Czech-Chinese ties, the amount has not been as much as expected. By the end of 2016, Czech president Zeman announced that investment from China were about to reach 50 bil. CZK which was unprecedented on the market of the size of Czech Republic however, according to the Czech Central Bank the actual amount was only 750 million USD, and the year after was less than half of that figure (Czech News Agency, 2016).

Other major investments (beyond CzechInvest's responsibility) include the acquisition of China Energy Company Limited (CEFC). An important investment in September 2017 was the establishment of a branch of the Chinese bank ICBC in the Czech Republic (Czech National Bank, 2019). The most prominent Chinese investor overall is the private-owned conglomerate CEFC that established its European base in Prague in 2015. It concentrated on collecting assets and it has been active in many fields, such as oil and gas trade, real estate, logistics, finance, tourism, infrastructure and others (Debiec and Jakóbowski, 2018).

4 Conclusion

China experienced a change in the perception of Czech Republic especially after its accession to European Union in 2004. Currently, Czech Republic and China have been enjoying a stronger relationship with the focus on the economic cooperation based on defining the relevant policy framework in top-level visits in recent years,

The Czech Republic benefits from its geographical location, industrial tradition and good production network with other European Union countries. China's investments were predominantly in the form of capital inputs and acquisitions, which for the most part do not participate in building greenfield sites and job creation.

However, Chinese investment in the Czech Republic remains relatively low, also in comparison with investments from other Asian countries such as Japan, Korea or Taiwan. Although Chinese investment in the Czech Republic and Central Europe has grown very much lately, the largest investors still come from the European Union (De Castro et al. 2017).

During the exanimated period 1993 to 2017, 29% of all Chinese capital on the Czech market were granted with the investment incentives. This ratio is not negligible however it also shows that majority of Chinese investment has not been able to apply for the financial support from Czech government. The reasons lie behind their localization in the regions, especially Central Bohemia and capital Prague, that are not included in the investment system. Moreover, these investors are concentrated in the sectors, such as tourism, infrastructure or for example real estate, that are also not applicable for the incentives.

In view of current situation of the Czech labor market with the characteristic of experiencing period of unemployment rate below NAIRU and consequent inflation gap, the topic of investment incentives requiring new jobs creation becomes even more debatable. This situation creates even higher pressure on the local labor market and increase attractiveness for the foreign labor and thus the immigration from expecially third country nations.

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