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THE EU'S EXTERNAL RELATIONS: THE CASE OF BRIC COUNTRIES WITH SPECIAL EMPHASIS ON CHINA

The BRIC countries, and especially China, have significantly increased their share in the world economy. The Chinese model, with its special approach to development, can be seen as an accelerated version of the Japanese one, which has brought enormous success in Japan, and in the Tiger economies. In the past two decades China has become the EU's most important trading partner, and their relationship is getting more and more symmetric. Although there are areas where they have different approaches, there are much more issues with common interests, and room for cooperation. For Hungary China has been a special partner for decades. After the fall of communism the ties became weaker, and Hungary practically lost almost all of its previous advantage. The EU accession, however, opened up new possibilities, and new channels for the country, to pursue its interests, and regain at least some of its privilegized status.
JEL: F01; F15; F49

Introduction

The so-called BRIC countries, Brazil, Russia, India, and China, are increasingly important players in the world economy. Their significance has been growing in an astonishing pace, and they are threatening the traditional leading role of the United States, the European Union, and Japan. The Triad has been dominating the world economy since the 1960s, both in terms of GDP, trade, and investments. Nobody really thought that their leading role would be challenged already in the turn of the millennium. Though in relative (per capita) terms these countries are still miles ahead of the BRIC countries, the gap in absolute numbers has been heavily reduced in the last three decades. It was the breathtaking growth in China that led this turnaround, but also India has been showing remarkable performance since the beginning of the reforms in 1991. Besides, both Brazil and Russia are showing themselves as forces to be reckoned with.

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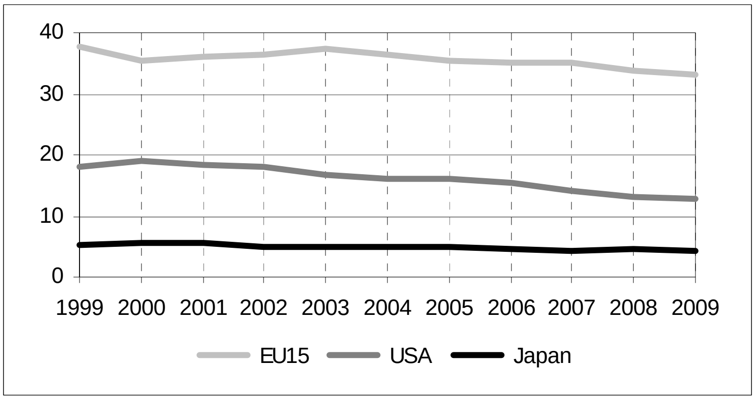
In this paper we will try to demonstrate that this shift of power has deep and relevant consequences not only in the realm of economic processes, but also in the way we think about them. In the first part we review recent trends in the world economy illustrating the shift of power from the traditional developed countries to the BRIC group of emerging countries. Of course it does not mean that either the US or the EU are to lose their leading role in the world, only a new, and significant trend seems to be emerging. The second part of the paper analyzes the bilateral relationship between China, and the EU, and touches some important questions regarding strategic considerations. In the third part we address a special issue: what role can a small, export oriented country like Hungary, play in shaping the policy towards China. We sum up our paper with a brief conclusion.

New Players in the World Stage

If we take a look at the Triad's (the United States, the European Union, and Japan) share in world trade, we can recognize a slow but significant decline. This pattern is clearly shown both in Figure 1, and Figure 2:

Figure 1

The Triad's share of world imports (%)

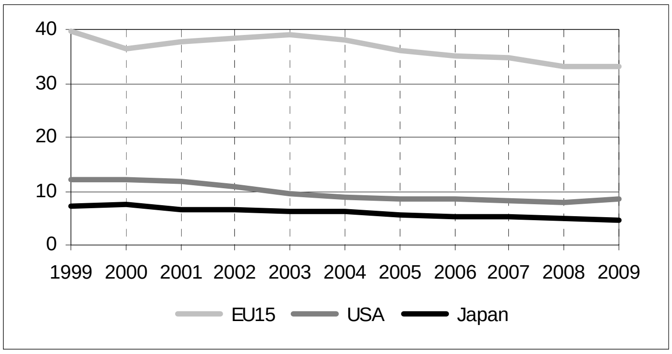


Source of data: World Bank (Web)

In Figure 1 we can see that although all three regions lost in terms of share in world imports, the biggest loser were the United States. During less than a decade their share decreased from nearly 19 percent to below 13 percent. Moreover, the decrease happened in spite of the strong consumption in the country, which underlines the rapid increase in imports in fast growing emerging economies. The EU lost 4, Japan 1 percentage points. Compared to their performance in world imports, the Triad's relative decrease in exports was even higher. Here it was not only the United States (with a decrease from more than 12 to 8.5 percent) that suffered heavy losses, but also the EU (from 40 to 33 percent), and Japan (from 7.3 to 4.7 percent). Altogether the Triad's share in world imports decreased from 60 to 50 percent, while in exports from 59 to 41 percent.

Figure 2

The Triad's share of world exports (%)

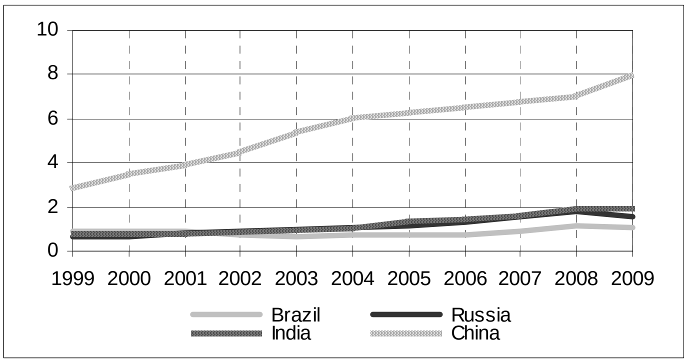


Source of data: World Bank (Web)

On the other hand, there are emerging countries that strongly increased their share in world trade. As far as the BRIC countries concerned, their performances are shown in Figure 3, and Figure 4. Though it was not only China that produced huge increases, its performance have been extraordinary. From a share of less than 3 percent in 1999 they went on to increase it by no less than 5 percentage points to more than 8 percent in a decade. The combined share of the remaining three countries also increased enormously, and almost doubled from 2.4 to 4.5 percent.

Figure 3

The BRIC countries' share of world imports (%)

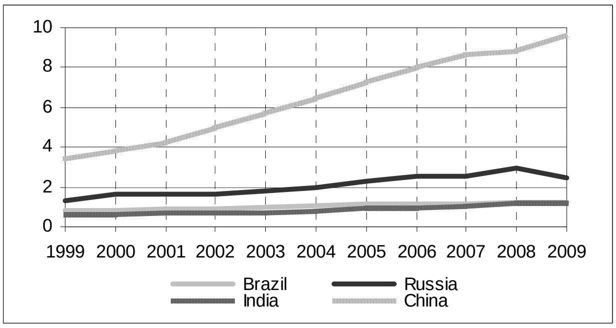


Source of data: World Bank (Web)

Because China is touted the factory of the world, and Russia is one of the most important oil and gas exporters, it is hardly surprising that the four countries' export performances grew even faster than their imports. In Figure 4 we can see that both China, and Russia have produced very rapid growth. Even if we take into account the relative setback of the Russian exports due to the financial crisis in 2009, the combined export share of these two countries has grown from 4.7 to 12.1 percent. Another good performer has been India, which has managed to double its share in world exports during the last decade reaching 1.2 percent.

Figure 4

The BRIC countries' share of world exports (%)



Source of data: World Bank (Web)

As we can see from previous data China has not only been the fastest growing emerging country in the last three decades but also had the fastest growing foreign sector in the world economy. China began its success story in the 1980s as a low cost exporter of light industrial products, mainly textiles. It was a sharp departure from the socialist way of industrialization with strong preferences to heavy industry. After the formation of the People's Republic of China, the new leaders, especially Mao, thought that heavy industry had to be created first to start the whole industrial process. This approach, however, had not been dropped, and after nearly three decades with poor, and declining industrial performances, still marked the thinking of the party nomenclature. But after Deng initiated the process of Reform and Opening up the situation changed.

China, at least in part, adopted an export oriented strategy, based upon its comparative, and competitive advantages. The whole state sector, however, remained intact, and the newly created Special Economic Zones served as a laboratory for experiments with capitalistic forms of production. Because the factories in the zones produced solely for exports, they had to be competitive in international markets. For this purpose they tried to make use of the cheap labor force of these areas, and invested heavily in textiles industry. Though initially there were no links between the Zones, and the traditional socialist part of the economy, the unexpected successes, and the increasing need for labor slowly began to transform the whole economy.

The strategy of the Zones based upon the highly successful Japanese model. Japan back in the 1950s started its trade expansion with low cost labor intensive products, like textiles. After a decade they were able to step up in the technology ladder, and launched an offensive in heavy industries. In the 1960s, and 1970s Japan emerged as a huge automobile exporter. They became fierce competitors of European, and American car manufacturers, and by the 1980s Japan became one of the most developed industrial country in the world. Due to their growing export operations, they were searching for additional ways to exploit their successes. They again made a step up in the technology ladder, and penetrated the electronics industry. So, during the past half of the century Japan has achieved enormous reputation in the world economy, first as an exporter of light industrial products, later as an aggressive player in the machinery markets, and by the 1990s as a high tech exporter. We have to admit, however, that the Japanese industrial base were first created in the 1930s, and were destroyed during World War II. From this point of view they had to rebuild it from the ruins of the huge enterprise groups, the so called Zaibatsu, as opposed to the Chinese case, where there were no such antecedents of modern industrial development.

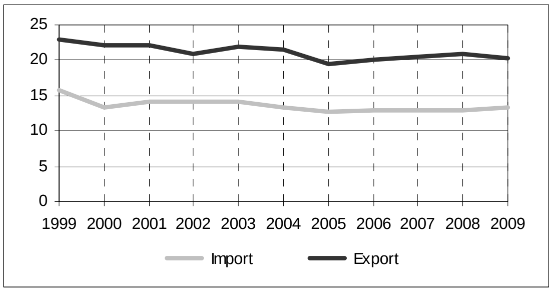
The development path of the Zones, and later the whole coastal region has been extremely similar to that of Japan, and later the so called Tiger economies (Hong-Kong, Taiwan, Singapore, and South Korea). China managed to build up a healthy industrial structure in these regions that was very competitive in international markets. They step-by-step moved upwards in the technology ladder, and by the turn of the millennium they had exported not only cheap labor intensive light industrial products, but more and more machinery and high tech goods. Though Chinese manufacturers are not yet among the leading innovators in the world, they are capable of producing high tech products with the help of foreign technologies. In this sense we can conclude that China has been able to go along the development path of an export oriented country during a time span considerably less than its predecessors. We can also see drastic changes in economic processes in the mainland, and rapidly shrinking differences between the mainly foreign invested sector, and that of dominated by the state owned enterprises. Despite being a communist country, China became the most successful representative of capitalism. In the next part we try to characterize the Chinese development from the point of view of Europe.

China and the EU

Unlike in the 19th century, after the reform process had begun in 1979, Europeans were not among the first movers in China. Hong-Kong, Taiwan, and the United States invested significantly more in the first years than European countries (see e.g. **Székely-Doby** (2009)). Though being somewhat late starters, Europe had been able to close up by the middle of the 1990s, and became the most important trading partner of China.

Figure 5

EU27's share in China's foreign trade (%)

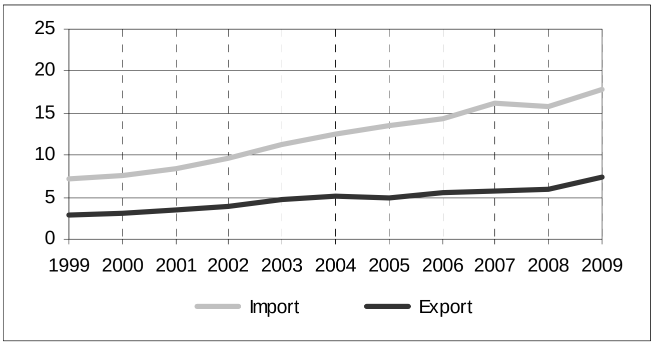


Source of data: European Commission (Web)

First, let's take a look at the graphs showing up in Figure 5. We can see that the 27 member states of the European Union give 17 percent of Chinese foreign trade. More than 20 percent of Chinese exports went to, while 13 percent of Chinese imports came from Europe in 2009. The importance of these countries were actually higher a decade ago, when their combined share stood at almost 20 percent. Despite the dynamic growth both in terms of exports, and imports (trade grew more than fourfold between 1999 and 2009) the relative decline of Europe can be attributed to the even stronger Chinese export performance vis-a-vis other countries, most notably the United States. Another interesting feature of the trend is the relatively stable pattern of trade shares during the crisis.

Figure 6

China's share in EU27's extra EU trade (%)



Source of data: European Commission (Web)

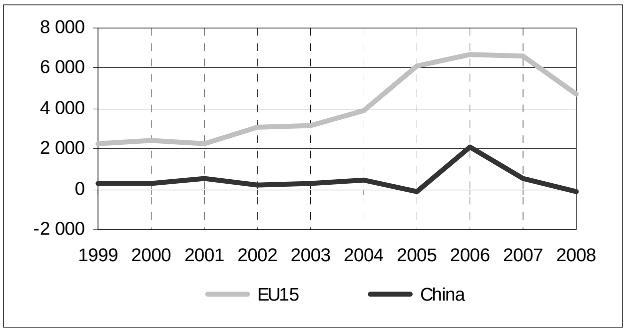
Much more interesting is China's rise as a trading partner of Europe. We can see in Figure 6 that the share of China in the EU27's extra EU trade was only around 5 percent in 1999. We refer here to the notion that European nations were late starters in China, so trade, which is directly influenced by direct investments, began to rise only after the middle of the 1990s. This relatively low share was further underpinned by the very strong ties that connected Europe to developed nations (most importantly to the USA, and Japan), and to petroleum exporting countries (first of all to Russia). So, the difference between the shares of China, and the EU in each others external trade is attributable to the mere size of their external trade sector. European external trade was more than four times bigger than that of China.

Taking into account this discrepancy it is even more striking to see that China's share has grown nearly threefold during the last decade. In 2009 it stood at 18 percent in imports, and 7.5 percent in exports. Compared to the data shown in Figure 5 we can notice a strong trend of leveling off. Though the relative importance of China as a trading partner of Europe is still lags behind that of Europe as a partner of China, the trends are very clear: differences are fading away. The asymmetric relationship which characterized the relationship between the EU, and China back in the 1980s has gone through a fundamental change, and has become much more symmetrical by now. As far as the balance concerned, there has always been a huge European deficit. In 1999 it stood at only 33 billion Euros, but a decade later it surpassed 130 billion Euros. Although we can conclude that the external trade of the

27 EU member states has the biggest deficit vis-a-vis China, in part this reflects the extensive investments and re-export operations of large European companies.

Figure 7

Bilateral FDI flows (million EUR)

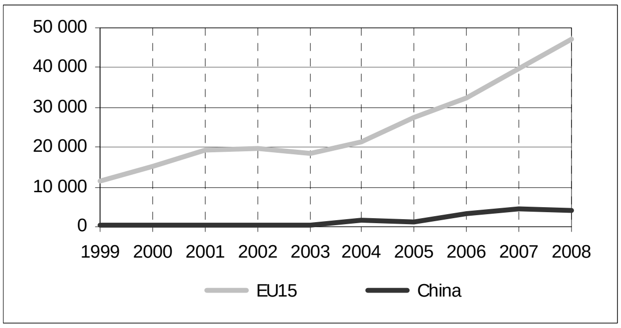


Source of data: European Commission (Web)

Because trade statistics alone between two regions never tells us the complete story we now turn our attention to direct investment flows, and stock data. In Figure 7 one can see that European FDI flows to China showed a quite stable pattern of around 2 billion Euros until the turn of the millennium. However, from this point on, investment flows had begun to increase, and surpassed 6 billion Euros in 2005. As a consequence of the financial crisis it dropped below 5 billion Euros in 2008 (the last year from which we have reliable data). Though significantly less than European investments in China, Chinese investments has also shown an increase in the last decade. Inflows have been in the region of 300-500 million of Euros for years, but both in 2006, and 2007 the amounts were considerably higher (2.1 billion, and 550 million Euros, respectively). We expect that the trend will continue, and Chinese investors will become much more active in Europe than before. This approach will be fuelled by the consequences of the financial crisis, namely the shortage of liquidity from the European side, and the huge foreign exchange reserves from the Chinese side. Chinese capital could be especially useful in financing the increasing budget deficits of some EU member countries.

Figure 8

Bilateral FDI stocks (million EUR)



Source of data: European Commission (Web)

The behavior of investment flows is reflected well by the stock data shown in Figure 8. Both European, and Chinese FDI stocks have shown rapid increase from 2004 on. This was the first year when cumulated European investments surpassed 20 billion Euros, and Chinese investments 1 billion Euros. In 2008 the former stood at 47 billion Euros, the latter at 4.7 billion Euros. Though both the EU, and China have investors more important, the relative importance of these two regions in their foreign investments has increased substantially.

After summing up the most important features of bilateral trade, and investment relations it is time to make some remarks about the strategic aspects of the relationship between China, and the EU. Following **Inotai** (2007) we can make three groups of strategic questions according to the level of cooperation and/or conflict. In the first group there are areas where common interests govern the processes. Both bilateral trade and strong commitment towards the fight against terrorism are good examples to continued cooperation of China, and the EU. In the second group there are strategic interests where elements of both cooperation, and conflict can be found. Perhaps the most notable area here is the somewhat different approach to international affairs. While the EU promotes multilateralism, the Chinese rather emphasizes multipolarism. Though the two concept have similar roots, and share numerous values, there are also marked differences between them. While the notion of multilateralism rests upon global governance, and increasing role of supranational institutions, multipolarism is based upon the concept of balance of power, where the main players follow their vested interests, and their actions are aiming to maximize utility. In the theory of international politics the former corresponds to the liberal, the latter to the realist approach (see e. g. **Brown** (2002)).

There are two additional areas where both cooperation, and conflict can be found. The first is the future of international organizations like IMF, and World Bank, where the EU, and China are in different positions, but have mainly common interests. The second one is energy. Here we can also find both conflicts and room for cooperation. At last, the third group of strategic concepts shows rather different interests. Here we can refer to different cultural characteristics, or value-systems. Though all the three groups consists of important questions, we are convinced that the need for cooperation between China, and the EU is stronger than the threat of potential conflicts.

The Role of Hungary in the EU-China Dialogue

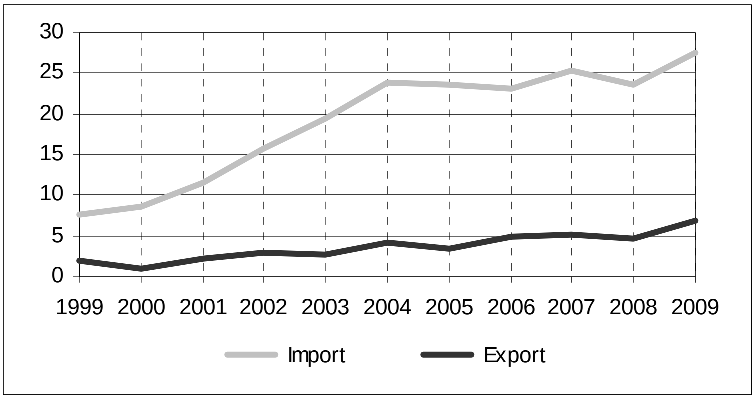
On 1st May 2004 Hungary became member of the European Union. From that point on Hungary, along with other Central European countries, has been empowered to directly shape the policy of the Union. Though their voting power are not too strong, they really have the possibility to shape their future. In this part of the paper we try to address the question: what a small, export oriented country like Hungary, can do to promote, and make use of the linkages between China, and the European Union.

Traditionally Hungary and China have been in good relationship due to their common communist past. In addition, because ancient Hungarian tribes stemmed from the borderline of China, they consider us as the descendants of the Huns. This special relationship resulted in tighter linkages in the decades after World War II, especially in the field of education. Lots of students from Hungary had the opportunity to study in China, and vice versa. Though trade linkages were not too strong, Hungary managed to achieve a special status from Chinese point of view in Eastern Europe. Interest became even higher when in 1968 Hungary tried to introduce a special kind of reform socialism, which meant a viable path for China to follow. Of course, by the launching of the reform process in 1979, they had learnt the lessons of avoiding mistakes, and have applied only elements of the Hungarian approach. In any way, on the eve of the systemic transformation, Hungary was in a very good position to build upon these close ties to China. Unfortunately after the transformation process had begun, Hungarian leaders had several other problems to solve, and let these opportunities unexploited (see **Székely-Doby** (2007)).

Joining the European Union, however, brought a new impetus to strengthening linkages with China. This opportunity meant not only that Hungary had equal rights in the policy process, and could shape European policy, but also opened up a new channel where Hungarian interests could be promoted. In fact as a full member of the Union Hungary had two levels to influence the relationship with China. We all know that stakes are very high. China has a huge market (perhaps sometimes a bit too big for a country like Hungary) with lots of unexplored export possibilities, and, at the same time, has a large capital pool, which is quite rare nowadays after the crisis. To mention some areas with excellent export prospects we refer to environmental technologies, first of all water cleaning equipments, but there are also good opportunities in the food industry. On the other hand Hungary offers a very good base for logistical centers, as well as transportation, redistribution, and packaging of Chinese goods. But perhaps the brightest prospects in cooperation appear in research, and education, because here one can build upon the successes of the past.

Figure 9

China's share in Hungary's extra EU27 trade (%)

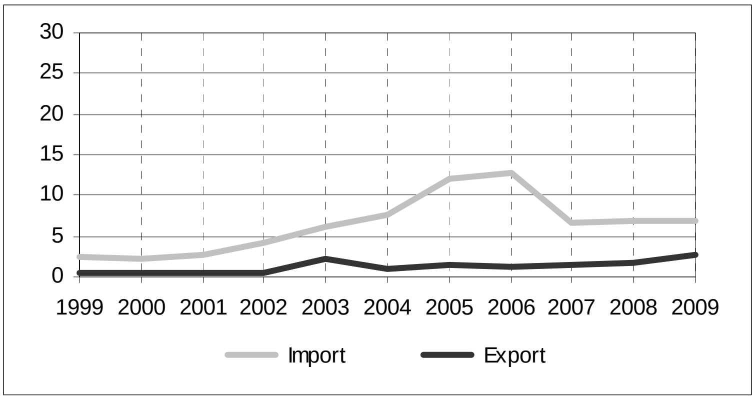


Source of data: European Commission (Web)

After talking about strategic issues let us take a closer look to trade issues. As we can see in Figure 9 in line with the EU accession process China's share in Hungary's extra EU27 trade increased significantly. In imports it exceeded 25 percent, and in export 7 percent in 2009. We saw earlier that the same numbers for the 27 EU member states were 18, and 7.5 percent, respectively. That is Hungary has relatively stronger ties towards China than the European average. Although it is rather the import side where China has relatively more influence in Hungary (the deficit was nearly 4 billion Euros in 2009), it can be seen as a substitute for more expensive import sources, and thus may be a favorable phenomenon. As a comparison it is worth to have a look at the data of a newly accessed European country, Bulgaria. Figure 10 shows that China is a significantly less important trading partner of Bulgaria than that of Hungary. Moreover, its share is much lower than the European average.

Figure 10

China's share in Bulgaria's extra EU27 trade (%)



Source of data: European Commission (Web)

Conclusions

The BRIC countries, and especially China, have significantly increased their share in the world economy, and in world trade as well. Though they are not yet ready to take over the leading role from the US, the EU, and Japan, this new trend of shifting power is undisputable. From the BRIC countries we can single out China with its extraordinary performance, and special approach to development. In fact, the Chinese model can be seen as an accelerated version of the Japanese one, which has brought enormous success in the so called Tiger economies.

In the past two decades China became the EU's most important trading partner. China's share in trade, and capital flows increased rapidly, and their relationship got more and more symmetric. Although there are areas where they have different interests, there are much more issues with common interests, and room for cooperation. For Hungary China has been a special partner for decades. After the fall of communism the ties became weaker, and Hungary practically lost almost all of its previous advantage. The EU accession, however, opened up new possibilities, and new channels for the country, to pursue its interests, and regain at least some of its privilegized status.

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