

## **An analysis of the bilateral economic relationship between China and Ireland**

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The role of investment and trade has been of vital importance to the economic development of Ireland and China respectively. Bilateral trade between the two nations has gradually increased year by year. The purpose of this article is to analyse the features and trends of this relationship.

Foreign direct investment (FDI) has been a cornerstone of China's economic development. From an outsiders perspective China's success in trade is remarkable. Since opening up, China's trade boom was ushered along in the 1990's with Deng Xiaoping adopting a reinvigorated and more dynamic approach in policy formulation. After ascension to the World Trade Organisation in 2001, growth continued to accelerate.

China is now in a transition period and there is a need to adjust to slower growth rates. China is pushing to further develop the service and private sectors of the economy. Foreign firms are now in competition with native firms across many sectors. The opportunity presented to us by the Chinese market continues to grow while at the same time China's rising middle class and the purchasing power of the Chinese citizens all contribute to the economic evolution of the People's Republic of China. Although growth has slowed and will most likely continue to do so, China will continue be one of the major world economies for the foreseeable future.

China's market size alone makes it different from nearly all other nations. The role of trade and FDI has been vital to China's development. China's export-led development strategy has been very successful. Large investing firms see the development of the Chinese market and the subsequent investment to follow as a natural step in the expansion of global operations. Some analysts argue that access to markets abroad is one of the biggest motivations behind outward FDI.(O'Brien, 2011) China is a transition economy but still shows traces of one that is centrally planned. Chinese Government intervention in economic matters seems to occur at a greater extent than in Western economies. There can be quite a close relationship between state involvement and market intervention.

Given the crucial role of China in the global economy and its status as the biggest recipient of inward FDI, it is appropriate to examine the conditions of the Ireland China bilateral trade and investment relationship. At a bilateral and multilateral level, China wants to establish solid trading routes with many of the EU members. (O'Brien, 2011)

Beginning in the mid-1990s, the Irish economy experienced dramatic economic growth that continued for well over a decade. Irish firms were keen to broaden their horizons and tap into new markets and new areas to invest. The Irish economy had matured to the extent that this was a viable option. A key point highlighted in Barry's 2002 model on Irish outward investment is that *"with increasing economic prosperity, a country evolves from being a net recipient of investment to being a net outward investor."*

Ireland still maintains a low corporate tax rate and some IT giants such as Google, Apple, Amazon, Facebook, LinkedIn have operations in Ireland. (Prime, 2014)

Ireland is an incredibly open economy and there is heavy reliance on exports which account for almost 80% of GDP. Trade understandably plays a crucial role in Ireland's future. FDI has also made a large contribution to Ireland's success. However the majority of foreign investment has come from the US

and several EU member states. (Davidson et al, 2011) Ireland is a small open economy slowly emerging from the troubles of economic depression. Perhaps the best way facilitate recovery is to categorise increasing exports as an economic necessity. China's rise to economic greatness has created opportunities never seen before. The initial investment and the waves that followed have garnered much academic and business interest from around the world. Attempting to capture the Chinese market opportunity requires a deeper understanding of the salient features of the Chinese economy and the dynamic nature of the business climate. Generally speaking, a key element to understanding the composition of the Irish economy was the growth of exports/imports. But with the obscure and often opaque nature of Irish statistical data, it can make the details complicated to interpret.

The role of MNEs (multinational enterprises) in Ireland is an important factor. Ireland has an impressive history of attracting FDI and maintaining a strong relationship with MNEs and reaping the many benefits entailed. There is a growing habit of outward Irish FDI directed by the various MNEs with a presence in Ireland. Approximately 1000 MNCs (multinational corporations) have established operations in Ireland. Some of the features that attracted such MNCs include a low corporate tax of 12.5%, an overall successful economic history and a well-educated English speaking workforce. The low tax regime has been one of the major components in attracting foreign companies. (Deloitte, 2012)

Ireland is not just a market of around 5 million people, it is in fact a gateway to the EU. It's like a halfway point between Asia and the US that can operate within both respective time zones and is also an English speaking nation. In a nutshell, that's one of the best points Ireland has to offer. The lowest corporate tax in Europe is applicable to manufacturers operating in Ireland. Foreign firms also have access to skilled workforce with an excellent record in the fields of engineering, science and technology. The initial wave of Chinese success stories in Ireland will hopefully go on to draw more Chinese attention. At the foundation of Ireland's industrial plan remains the commitment to maintain a 12.5% corporate tax level in line with drawing in more foreign investment. Ireland has a lot to offer as a strategic location for multinational corporations. Irish policy promotes a highly driven, competitive, open and welcoming business environment. (Deloitte, 2012)

The bulk of exports from Ireland to China are in the area of pharmaceuticals and ICT goods. The activities of multinational corporations constitute a large portion of Irish trade and FDI. Irish firms tend to favour the high-end technology industry. As part of the government strategy, six clusters or specific sectors in China have been highlighted that present lucrative opportunities. These industries include: financial services, education, food and drink, ICT, construction, agricultural. Ireland has strong potential in these areas.

In a strategy published by the Irish government, it was stated that, "*Exporting is the route by which the economy will grow and create employment.*" (Davidson et al, 2011)

The aim of the Irish government's 'Asia Strategy' was to identify the sectors of the Irish economy which have the necessary ownership and internalisation advantages needed to makes use of China's locational advantages and manoeuvre around locational setbacks. The key focus of the strategy is trade. However, it can be argued that these sectors are also likely to gain traction in the investment world given the often complementary relationship of trade and investment. (O'Brien, 2011)

Over the past three decades since bilateral relations began, Irish firms have seen sales in China steadily grow, albeit at a relatively small level when compared to other Europeans. China's market size alone is attractive enough for the more tenacious Irish companies willing to commit. Progress in China has entailed a growing middle class with a higher disposable income and a desire to continue improving their quality of life, as is natural. In their push for a better life there is a need for expertise and technological know-how and this cannot always be satisfied by native firms. This is where countries like Ireland can step up to the mark.

The liberalisation of China's service sector holds huge potential for all involved. Industries such as banking, insurance, education, and telecommunications are under the watchful eye of foreign investors keen to move into such areas.

Sectors such as the financial services, construction, food, agriculture, and printing/publishing have traditionally been the largest targets pursued by Irish firms. Some of the Irish companies that have invested in China have established a strong foothold in the market and have made solid progress since entry. Consistent with prior research, one of the major contributing attractions was market size. To illustrate, allow me to use the example of cement company CRH. For the cement giant, it makes obvious sense why they should have a presence. China is the world's largest construction market. Urbanization is a big driver. There is more demand for building as a direct result of increasing urbanization. But there have been limited avenues for investment. That's one reason behind property explosion. The industry is in a transition period as it improves in structure and efficiency. Consolidation is likely to be key driver.

One possible explanation for the high level of investment in the traded sector is the rising middle class with a growing hunger for consumer goods. The Irish economy has a history which in recent times has largely focused on the service industry. As a result, Irish firms may not be well accustomed to follow and exploit popular consumer patterns in China. (O'Brien, 2011)

Included in the services sector are IT, telecoms, financial software, and education. Across all sectors, a great focus has gone into the areas of food and drink, electronics, IT, and construction. (O'Brien, 2011) There are now more possible opportunities in the food sector as a result of the change to the one child policy. The food sector could perhaps present a more lucrative opportunity than the IT or pharmaceutical sector.

Out of all the sectors, this could perhaps be the one with most promise for Irish. There are a number of reasons behind such a claim. As China has developed so too has the diet of the average Chinese citizen. Influenced by globalisation and the 'westernization' of peoples' diets, more meat and dairy products are being consumed in Asia. The rise of China's sizeable middle class and their growing spending power are also massive contributing factors. The greater spending power of the Chinese consumer along with the evolution and ease of e-commerce retailing allows access to a whole host of foreign goods. This could also be linked to the global trend of health consciousness. People are more aware and responsive to food trends and what nutrition enters the body. In China, there have been numerous scandals reported within the food industry. Foreign brands are generally deemed more credible, safe, of better quality and more trustworthy. Foreign brands often fetch a higher price.

Chinese people in particular are cautious and wary of certain food purchases. And for good reason. In 2005, there was the melamine poisoning tragedy involving young infants. As the spending power of the Chinese increases, more attention is being paid to the quality of food consumed. As a result of modern agriculture and a better knowledge of nutrition, organic food is now increasingly popular. Ireland has a good reputation in food safety and quality and the food sector in China presents a wealth of opportunities for Irish firms.

Another recent development worth contemplating is the implication of changes to the one child policy. China's older generation of pensioners will most likely increase and now that families are allowed to have more children, what will this mean for future demand? The demographics of China's population will again change over the next few decades and it will be interesting to see what opportunities will be presented.

China's dairy consumption has risen rapidly since the nutritional benefits were realised and this message was relayed to the people. Traditionally, very little dairy would have been consumed by the Han Chinese and dairy consumption would have been generally limited to the border regions of China.

It now seems in China that dairy has more of an association with health than anything else. Great importance is given to which brand of milk is to be bought for the children. Often at extortionate prices, the best foreign brand is purchased.

The older generations are more health conscious and aware of the alleged benefits of dairy intake. This too presents a possible niche or a possible outlet for specialised products (e.g. dairy goods tailored to a specific cohort of people.)

This rise in demand for dairy across China is good news for Ireland. In 2015, the EU quota on dairy output in Ireland was lifted thus allowing unlimited exports of dairy goods. The small island nation on the periphery of Europe has a sterling reputation in terms of dairy production. A number of the big Irish dairy producers have established solid positions in China and are in general expanding operations. The Chinese demand for dairy has been exponentially rising year by year and is expected to continue to do so,

Currently, the biggest component of Ireland's dairy exports to China is dairy formula and is usually sold on a business to business means rather than business to consumer as the retail market may be too over burdening.

Multinational enterprises within the food industry have chosen to concentrate on the business to business method rather than directly penetrating the retail world which is perceived by some as too complex for foreign companies to break into. The decision to concentrate on the business to business market rather than the retail sector was made by some. Given the huge distance from between Ireland and China along with advertising/marketing challenges, this could create quite a complex situation. (O'Brien, 2011)

Ireland is one of the first countries in Europe to be granted access to export beef to China following the foot and mouth disease outbreak at the turn of the millennium. Chinese beef consumption has been approximated at around six million tonnes per year. This figure is expected to increase to seven million within the next five years. (RTE, 2015) This presents another potentially lucrative opportunity for Irish firms.

The core assets found among Irish firms are predominantly in the areas of management and expertise in the non-traded sector. However this contrasts to what has been happening in China. Most of the Irish FDI to China thus far has been in the traded sector. (O'Brien, 2011)

Ireland's capabilities in the financial services sector could prove useful for exploiting China's market opportunities. As the demand for financial services in China increases, more opportunities and avenues for investment will emerge. Ireland a proven track record in the Financial services sector and as such it is reasonable to assume that it is a sector to watch out for.

Irish investment in China does not conform to standard outward FDI to other destinations such as the US or Western Europe. "Irish outward FDI is disproportionately horizontal and largely in the non-traded sector. Irish FDI in China is predominantly in the traded sector and marginally horizontal." (O'Brien, 2011) Previous analysis conducted by Barry et al (2002) indicates that *"Ireland's outward FDI flows are disproportionately horizontal and orientated towards non-internationally-tradable sectors."*

What are the Determinants of FDI into China?

1. Market Potential
2. Low Labour Cost
3. Rich Resources

4. Investment Climate: - government policies, - investment incentives, - import substitution, - political stability,
  5. Others: - transportation cost, -follow the competitor, - technology transfer, - weak industry
- (O'Brien, 2011)

What are the core motivations for investing in Europe? Access to a highly integrated market, a robust regulatory system in place, a single currency, a strong emphasis on R&D activities, quality infrastructure, and an overall attractive investment climate with a number of incentives on offer are deemed as the main highlights. This market features continue to attract investment on both sides.

The issue of intellectual property rights infringement is identified by many Westerners as a serious deterrent of investment into China. Like many things in China, it can happen on a gargantuan scale. The lack of respect for technology and software can be quite prevalent. It is a key issue for consideration in the food industry, ICT, and the pharmaceutical sector especially. Experts have suggested, "That critical technologies should be kept outside the Chinese manufacturing process as a means of compartmentalising production and thereby reducing the risk of IPR theft." (O'Brien, 2011)" Solid intellectual property rights can prove difficult to enforce throughout the whole country. A lack of strong, legal IP protection can in fact deter potential investors. This lack of appropriate protection is viewed by some as a "*significant barrier to trade in China*". (O'Brien, 2011)

Out of all the locational disadvantages, poor IP protection was cited as the most problematic. This is a significant point for Irish investors to consider in light of their tendency to focus on the high-tech sector. Failure to take the necessary steps to protect the core ownership advantage could put Irish firms at risk. We can confidently say that the Chinese business climate is quite a different scenario compared to what Irish investors previously would have encountered.

Similar to the case of intellectual property rights, contract law has been cited as a cause for concern. The lack of a clear, transparent, predictable contract law also undoubtedly acts as a deterrent. The general consensus among many Irish investors is fundamentally on taking advantage of Chinese market opportunity. The challenges in the regulatory and cultural environments were usually centred on the lack of respect for intellectual property rights and contract law. Few enforceable rights were at hand when the topic of contract law was brought up. (O'Brien, 2011)

For more than 25 years China has formulated a system of laws and a regulatory framework shaped to handle Chinese and foreign investment parameters. These regulations include the Law on Joint Ventures, the Law on Wholly Owned Foreign Enterprises, and the Guidance Directory on Sectors open to FDI. A range of preferential policies have been established for those operating within special economic zones. (O'Brien, 2011)

From a global perspective, the World Trade Organization has laid out what needs to be done regarding China's international trade habits. There is still a need for China to continue with its path towards greater transparency and efficiency in terms of trade and investment policy regulation.

Investment last year reached \$10 billion according to a report put out by law firm Baker and McKenzie. Since 2000, Chinese investment in Ireland has amounted to \$142 billion. (Hancock, 2016) High-tech projects account for roughly half of FDI with the rest targeting such sectors as agriculture, food, financial and business services. The pinnacle so far of Chinese investment in Ireland was in 2013 when the Kang family from Beijing purchased two luxury hotel resorts in Cork. Ireland is a good base for multinational companies and there are a number of appealing factors that attract investment.

From the Chinese perspective, the core advantages of locating operations in Europe are as follows:

- access to a unified market,
- appropriate and efficient regulations,

- a single currency,
- a strong emphasis on R&D,
- quality infrastructure throughout,
- a range of FDI incentives.

(Deloitte, 2012)

## Conclusion

The role of trade and investment in Ireland has held great importance in economic development. With a concerted effort through exports and the continuation with FDI projects a boost to the economy is expected. Although China's approach to investment and the make-up of trading patterns is changing, FDI will continue to be an important element in the Chinese economy.

Traditionally, Irish outward FDI was disproportionately horizontal and largely in the non-traded sector. However, Irish FDI in China now is predominantly in the traded sector and marginally horizontal. Therefore, the Chinese investment climate is quite different from that experienced by Irish investors in other markets. With China's shifting stance regarding FDI, there is a possibility that more opportunities will become apparent, especially within the service sector. 'Market size' continues to be one of the biggest attractions for China. 'Locational disadvantages' in China may include the violation of Intellectual Property Rights and Contract Law. The threat of IP theft is a large enough deterrent to keep away certain investors, particularly in the high-tech sectors. Irish expertise generally lie in the areas of management and expertise in the non-traded sector. The six clusters that represent alluring market opportunities have been highlighted by the Irish government and these endeavours should be pursued for the sake of expansion. These sectors were discussed and opportunities presented.

Nowadays, FDI is increasingly targeting China's domestic market thus shifting the focus away from the heavy reliance on exports. While at the same time, FDI flows into the services sector also continue to grow. Given the nature and history of Ireland's economy, sustainable success is tied to the export sector, the low level of FDI investment from Asia to date, together with the huge potential of Chinese bilateral relations in the years ahead, an improvement in Ireland's performance should be made a priority."

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