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OPINION & REVIEWS

INDIA-SAUDI ARABIA TIES: BEYOND OIL DIPLOMACY

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The bilateral relationship between India and Saudi Arabia was restricted to New Delhi's dependence merely for oil and through the diaspora from whom India gets substantial remittances, which in 2015 was recorded nearly $11 billion, a new low after Indian expatriates were hit hard due to fall in global crude oil prices (Chaudhary, 2016). Both India and Saudi Arabia have begun to look beyond the oil business for a solution. A solution that could work as a catalyst to create a sustainable relationship for both the countries amidst the current economic situation and internal reforms taking place within Saudi Arabia. This paper shall discuss the economic factors which have propelled reforms within Saudi Arabia and India's pro-active outreach towards the Middle East.

Fall in Oil Prices

Oil prices have witnessed a steep fall by almost 58 per cent from around $110 a barrel in June 2014 to $45.89 a barrel on September 14, 2016 after recovering from 13-year low of $26.05 a barrel on February 11, 2016 by almost 76 per cent. The recovery of oil prices were largely In response to a slowing down of US oil production, which eventually resulted in the USA shutting down 460,000 barrels per day of high-cost production. On the other hand, since May 2016, Saudi Arabia has succeeded in adding 400,000 barrels per day to its production from a low-cost field, thereby toppling the US to become world's largest producer of crude and other liquid hydrocarbons since April 2014 following the shale oil boom.

While it is believed that the game of oil was largely being played between Saudi Arabia and the US, wherein the U.S. succeeded in maintaining its shale oil production by showing greater resilience through slashing their cost through improved techniques, Saudi Arabia still managed to gain an upper hand by again becoming a leader of oil production. This was reflected in capital investment cuts by the U.S. shale oil companies resulting in falling of their rig counts.

While the narrative does suggest Saudi is losing dominance over OPEC as an economic force, largely supported by quota violations of its member countries, it also suggests, Saudi Arabian urgency in supporting its Vision 2030, a strategy to transform its economy and society by 2030 (Vision 2030, n.d.) through raising the share of non-oil exports, increasing private sector contribution and foreign direct investment (FDI), but without doing away with its oil revenue. The simple reason being its quick monetizing of oil reserves in a carbon constrained world and push its economy towards renewables and other cleaner fuels, put into the context by recently appointed Saudi oil minister Khalid al-Falih, who stated that, "the objective of reducing reliance on oil 'does not mean that the kingdom's opportunities of optimising its benefits from its natural resources, including oil, will receive less attention in the current economic phase than in previous phases. Increasing our oil revenues will help us to build a range of other economic sectors in the kingdom, besides international investments" (Argus, 2016).

Saudi Arabia's energy sector: Changes taking place

Saudi Arabia, which has traditionally been the top suppliers of crude oil to India, has been overtaken by Iraq (Kennedy, 2016), which now is the largest crude oil supplier to India (Table 1).

While the reason for such decline is largely due to increased discounted crude imports from Iraq and later from Iran, particularly after removal of the sanctions, in their attempts to grab market shares, the decrease may well reflect Saudi Arabia's strategy to rely less on crude oil business. This is reflected in Table 2, which suggests diversification away from oil sector to include laying greater focus on increasing domestic natural gas production by increasing the capacity of dry gas production capacity from 12 billion cubic feet per day (bcf/d) to 17.8 bcf/d , ignoring an increase in petroleum production capacity by sticking to 12.5 million barrel per day (mb/d), increasing the generation capacity from renewable energy from nil to 3,450 megawatts (MW) so as to increase the share by 4 per cent as targeted for year 2020, with greater emphasis on local content requirement from 25 per cent to 35 per cent (Table 2), creating 7,774 jobs by 2020 (Fattouh-Sen, 2016).

Table 1. Country-wise import of crude oil from the Middle East during 2014-15 to 2016-17 (April-May) (P) in Million Metric Tonnes (MMT)

	2014-15				2015-16				2016-17 (April-May) (P)			
Country	PSU	JV	Priv.	Total	PSU	JV	Priv.	Total	PSU	JV	Priv.	Total
Iran	6.0	0.0	5.0	11.0	6.3	0.0	6.5	12.7	1.1	0.0	2.0	3.1
Iraq	17.7	3.2	3.6	24.5	22.1	4.9	8.8	36.8	5.7	1.0	1.2	8.0
Kuwait	14.1	2.2	1.5	17.9	8.6	2.0	0.4	11.0	1.7	0.2	0.1	2.0
Oman	0.0	0.1	0.6	0.8	0.0	0.6	0.0	0.6	0.0	0.3	0.1	0.4
Qatar	0.9	0.0	3.6	4.5	0.9	0.1	3.0	4.0	0.0	0.0	0.7	0.7
Saudi Arabia	16.2	6.2	12.6	35.0	17.5	7.9	15.0	40.4	2.9	1.2	2.6	6.7
UAE	10.2	0.0	5.9	16.1	11.9	0.1	3.7	15.7	1.8	0.0	1.0	2.8
Yemen	0.0	0.1	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Petroleum Planning and Analysis Cell. Priv.: Private

The evolution of Saudi Arabia's energy sector creates scope for India to chip in where it can too collaborate on a wider energy platform including tying in with its own renewable energy goals, particularly through India's 'International Solar Alliance' (ISA). Saudi Arabia is already on its list of prospective member countries and territories for ISA (ISA, n.d.). Through this alliance both the countries can work closely to curb down their respective energy emissions largely through promotion of scientific and technological cooperation, which will help them to move ahead with developing and collaborating on advanced solar technologies (MEA, 2016). Like India, Saudi Arabia too faces the stringent environmental challenges due to high local consumption of oil, prompting policy makers to focus on renewable and clean energy development.

There is thus a strong case for both the countries to go beyond buyer-seller relationships in the energy sector and build upon cooperation in the sphere of the broader energy sector to include renewable energy, spanning the scope of economic cooperation and collaborate more on security and defense with similar spirit.

Table 2. 2020 energy sector targets in the NTP			
Performance Indicator	Baseline	2020 Target	Unit
Petroleum production capacity	12.5	12.5	mb/d
Dry gas production capacity	12	17.8	bcf/d
Refining capacity	2.9	3.3	mb/d
Share of pharmaceutical sector in non-oil GDP	0.98	1.97	Percentage (%)
Efficient utilization of fuel in electricity power generation	33	40	Percentage (%)
Number of job opportunities in the mining sector	65	90	Thousand jobs
Decrease in water and electricity subsidies	0	200	SAR Billion
Generation from renewable energy	0	3,450	Megawatts (MW)
Share of renewable energy in total	0	4	Percentage (%)
Job opportunities for citizens in atomic and renewable sectors	500	7,774	Jobs
Local content contribution within the renewable sector	25	35	Percentage (%)
Source: Vision 2030 Kingdom of Saudi Arabia; Energy Aspects			

In this regard India's push for cooperating with Saudi Arabia beyond oil and King Salman's willingness to take risks to push for reforms through several measures along with Vision 2030, to include the National Transformation Programme (NTP), the programme for Strengthening Public Sector Governance, the Privatization programme, the Public Investment Fund Restructuring programme and the Saudi Aramco Strategic Transformation programme, places both the countries on a new landscape of bilateral relationship. Through this vision and mission both the countries are now able to give a new lease of life to their relationship which spans across several sectors providing enough opportunity for a renewed and unprecedented partnership.

Burgeoning Economic Relationship

Saudi Aramco's Strategic Transformation programme is a part of Saudi Arabia's Vision 2030, which could further help the country to do away with its oil addiction. Expected to become most valuable publicly listed company in the world, Saudi Aramco has planned to increase its efficiency and boost production above current levels, while creating new revenue stream for the country. Through this revenue Saudi Aramco shall look to expand the role of sectors like services and to ensure that the oil markets remain stable. Saudi Aramco needs Saudi Arabia to stay oil-centric to flourish in other sectors and help its diversification plans. The initial public offering of Saudi Aramco to the tune of 5 per cent of its value is expected to fetch $125 billion (Brinded, 2016).

Through its plans to prepare for partial privatization to diversifying its economy, Saudi Aramco is now looking at Indian markets. In this regard, India has already offered Saudi Aramco a stake in India's biggest oil refinery and petrochemicals project, proposed in coastal Maharashtra at an estimated cost of Rs. 1.5 trillion (PTI, 2016). This is a step towards Saudi Arabia's greater involvement in the oil and gas sector. The joint statement between India and Saudi Arabia has also looked at cooperating in renewable energy and the idea of an International Solar Alliance was appreciated by Saudi Arabia.

If one looks at economic cooperation between the two countries oil prices have hurt their bilateral trade (Table 3). During 2014-15, their bilateral trade reached $39.3 billion registering a decrease of 19.24 per cent compared to 2013-14 ($48.62 billion) due to sharp decline in oil prices since June 2014. Since import of crude oil forms a major component of bilateral trade with Saudi Arabia, therefore a need is felt to lay greater emphasis on expanding the trade portfolios to include other sectors too, an agenda common to both Indian policy makers and Saudi Arabia. The resetting of Saudi Arabia's trade portfolio could improve its current position as India's fourth largest trading partner. India would also benefit the widened range of the trade portfolio with Saudi Arabia.

Saudi Arabia is also home to the largest number of Indian Passport holders outside India, the total number of Indians in Saudi Arabia is estimated at 3 million, this is nearly half of the total number of Indians in Middle East which is 7.5 million. The composition of Indian migrants to Saudi Arabia has been changing with the percentage of professionals and skilled workers rising.

Table 3. India-Saudi Trade (in $ million)

Year	Imports from Saudi Arabia	Exports to Saudi Arabia	Total Trade	% Increase in bilateral trade	% increase in Indian imports	% increase in Indian exports
2010-11	20,385.28	4,684.40	25,069.68	19.35	19.23	19.90
2011-12	31,817.70	5,683.29	37,500.99	45.59	56.08	21.32
2012-13	33,998.11	9,785.84	43,783.95	16.75	6.85	72.18
2013-14	36,403.65	12,218.95	48,622.60	11.05	7.08	24.86
2014-15	28,107.56	11,161.43	39,268.99	-19.24	-22.79	-8.65

Source: Department of Commerce, Government of India (www.dgft.gov.in)

Investment and infrastructure key for economic diversification and growth

A further area of cooperation has been investment, which both countries have started to expand. In the past Saudi Arabian General Investment Authority (SAGIA) has issued 426 licenses to Indian companies for joint ventures and for 100 per cent owned entities until April 2015 with an expected total investment of $1.6 billion in Saudi Arabia. These licenses are spread across sectors like management and consultancy services, construction, telecommunications, IT, pharmaceuticals, etc. (Khan, 2016). Kingdom, being the 47th biggest investor in India has already invested $58.83 million during April 2015 to September 2015. Indian investors present in Saudi Arabia include, Larsen and Tubro, Tata, State Bank of India and Jet. IT giant TCS established a BPO in 2014. TCS was visited by Prime Minister, Narendra Modi during his visit to Saudi Arabia in April 2016.

India is also seeking more investment from Saudi Arabia and has expressed special interest in tapping into its Sovereign wealth fund, which is estimated at $2 trillion. During the Indian Prime Minister's visit a framework agreement was signed between the General Investment Authority in Saudi Arabia and Invest India aimed at facilitating investments by the private sectors in the two countries (Roy, 2016). The Prime Minister also urged Saudi Arabian Companies to invest in India's infrastructure, such as Roads, Highways and Ports, and projects like Make in India and Digital India.

Both sides realizing the importance of business players also emphasized on the need for exhibitions and fairs and increasing interactions between Chambers of Commerce, which have played an important role in enhancing engagement between both sides.

Changing contours of India's Look West Policy

Interestingly, over the past couple of years, India's Look West policy has also changed and is set to build upon the wider and broader scope of possible cooperation based on interdependency and cooperation which spans over several portfolios as has been the case with Saudi Arabia. This has been well noted during PM Modi's visits to United Arab Emirates (UAE), Qatar, Iran and Saudi Arabia and Foreign Minister, Sushma's visits to Bahrain, Israel and UAE and President of India's visits to Israel, Palestine and Jordan. Moreover, the Modi government has also hosted the emir of Qatar, the crown prince of Abu Dhabi, the Bahraini, Iranian, Omani, Saudi, Syrian, and UAE foreign ministers, as well as the Israeli defense minister to India. These high level bilateral exchanges and the range of agreements reached in such meetings only suggest the transformed West Asia policy of India, which is irrespective of the opposition of the Organisation of Islamic Cooperation (OIC) against India, which reaffirmed its principled support for the people of Jammu and Kashmir.

This new shift in the relationship has the potential to change the course of India's outlook towards this region and has been well reciprocated by countries like Saudi Arabia. Saudi Arabia, for instance is more determined than in the past to re-connect with their old partners in the region through their new Vision 2030 strategy. This includes, raising their share of non-oil exports in non-oil GDP, currently set at 50 per cent from the current 16 per cent; allowing greater FDI from current 3.8 per cent of GDP to 5.7 per cent and restructure their energy sector.

Building upon Delhi and Riyadh Declaration

The Delhi Declaration of 2006 forms the basis of enhanced cooperation between India and Saudi Arabia which has witnessed a broad spectrum of portfolios to include political, economic, security and defence areas, the signing of Riyadh Declaration during the visit of the then Prime Minister Manmohan Singh to Saudi Arabia in 2010 was a milestone in their relations. Ever since the establishment of diplomatic relations between the two country in 1947, it was agreements signed during both declarations that have cemented the relationship, with energy at its core. This helped Saudi Arabia to become India's largest crude oil supplier, although it has since been overtaken by Iraq. Given that energy must play a significant role in the sustainable economic development of both the countries, it is perhaps, high time for them to look beyond their oil diplomacy and expand the scope of energy cooperation to include clean energy technologies while shifting towards cleaner fuels such as natural gas and renewables.

Additionally, above declarations call upon to strengthen their strategic cooperation, including those issues which has been overlooked in the past. The Nitaqat Law of Saudi Arabia, enacted in 2011, for instance, was directed against Indian workers which forced 1.41 lakh Indians to leave Saudi Arabia between April 6 and November 3, 2013 (PIB, 2014). Concerns were once again raised about such law when consequent to the fall in the global oil prices large number of expatriates became jobless and are now send back to India. Thus, these issues prompted both the countries to diversify their trade which goes beyond oil.

All these can be worked out through Saudi Arabia's Vision 2030 strategy, which aligns well with India's new Look West Policy to expand beyond a buyer-seller relationship. This was highlighted well by Modi's visit to Saudi Arabia in April 2016, only few days before announcement of Vision 2030.

Strategic Sphere: De-hyphenation from Pakistan

The real change which is taking place in India's ties with Saudi Arabia and even in other GCC countries like UAE and Qatar is de-hyphenation from Pakistan, and support for India in the fight against terrorism.

Adel Al Jubeir Saudi Foreign Minister in an interview to an Indian Newspaper *Times of India* stated (Bagchi, 2016) that, „Pakistan is an historic ally and will remain so. Our relations with Pakistan do not come at the expense of our relations with India. India is a strategic relationship in all fields."

During Prime Minister Modi's visit to Saudi Arabia, there was a clear reference to greater cooperation between both countries in taking on terrorism of all hues, which was also referenced in the Joint Statement as under: „Affirming that the menace of extremism and terrorism threatens all nations and societies, the two leaders rejected totally any attempt to link this universal phenomenon to any particular race, religion or culture. They called on all states to reject the use of terrorism against other countries; dismantle terrorism infrastructures where they happen to exist and to cut off any kind of support and financing to the terrorists operating and perpetrating terrorism from their territories against other states; and bring perpetrators of acts of terrorism to justic"' (MEA, 2016).

Saudi Arabia has in the past backed Islamabad, however, over the past fifteen years there has been a change in Riyadh's approach towards India. In 2001 during the visit of Jaswant Singh then Saudi Foreign Minister first spoke about de-hyphenation of India and Pakistan. An extradition treaty was signed during former Prime Minister Dr. Manmohan Singh's visit to Saudi Arabia in 2010, and since 2012 several terrorists have been expedited to India by Saudi this includes Syed Zabiuddin Ansari alias Abu Jundal a LET operative and one of the key handlers of the 26/11 attackers.

There are several reasons for this de-hyphenation of India from Pakistan. The first is economic rationale. India's increasing energy needs mean that while other countries may become less dependent upon Saudi Arabia for oil, India's dependence is not likely to reduce soon. Second, is the level of bilateral trade, Pakistan-Saudi Arabia bilateral trade is 6 Billion USD, compared to 39.1 Billion USD between India and Saudi Arabia.

Both sides have invested heavily invested in strengthening not just the economic but also strategic partnership. The foundations for a strong strategic partnership have been built over the past decade. Saudi King Abdullah visited India in 2006, while former Prime Minister Dr. Manmohan Singh visited Saudi Arabia in 2010. This point was acknowledged in the joint declaration during Prime Minister Modi's visit to Saudi Arabia (MEA, 2016).

They expressed satisfaction at the regular exchange of high-level visits between the two countries, underlining that the Delhi Declaration (2006) and the Riyadh Declaration (2010) elevated the mutually beneficial bilateral relations to the level of 'Strategic Partnership'. During Salman's visit in 2014 a defence cooperation pact took their strategic partnership further into areas of security. This defence cooperation will facilitate exchange of defence-related information, military training and education (Live Mint, 2014).

The growing menace of terrorism has resulted in Riyadh also taking a more nuanced position. Saudi Arabia itself has alerted itself to the threat of terrorism, recent terror attacks in Medina and one suspect likely to be from Pakistan will adversely impact the relationship with Pakistan. Even before these attacks, relations between Saudi Arabia and Pakistan had soured due to Pakistan's refusal to join the Saudi coalition against Yemen.

Third, India's improvement in ties with the US too has played a role in Saudi's approach towards India. In fact, it has been argued that the extradition of terrorists would not have been possible without USA playing an important role. Interestingly, on the eve of Prime Minister Modi's visit to Riyadh, the US and Saudi Arabia announced that they would take joint action to block funding of organizations such as, al-Qaida, the Taliban, and Lashkar-e-Taiba (LeT) and individual LeT operatives Naveed Qamar, Abdul Aziz Nuristani, and Mohammed Ejaz Safarash (Rajghatta, 2016).

In addition, India's pro-active 'Look West Policy' in recent years, where it has had to balance relations between GCC countries and Iran has also played an important role in de-hyphenating from India and Pakistan. The current government under Narendra Modi has also been seeking to become more pro-active in the Middle East and West Asia, since it has been argued in the past that unlike other major global players like China, India has not been pro-active enough. Apart from Modi's recent visits to Qatar, Iran, Saudi Arabia several high-level functionaries from GCC countries including the emir of Qatar, the crown prince of Abu Dhabi, the Bahraini, Iranian, Omani, Saudi, Syrian, and UAE foreign ministers visited India, the Israeli defence minister also visited India. Indian foreign minister Sushma Swaraj has also visited both the GCC countries such as Bahrain, Oman, and the UAE along with Israel, the Palestinian territories, Jordan (Madan, 2016). The government has thus carefully sought to balance ties between GCC countries and Iran, while not losing sight of the strategic importance of Israel.

Key Challenges to look out for

There are off course significant challenges to the India's relationship with Saudi Arabia. In the strategic sphere the likely challenge is going to be India's burgeoning strategic and economic partnership with Iran, which has strained relations with Saudi Arabia. It remains to be seen how India will tackle this, given the increasing strains between the two, and the harsh resolution passed at the OIC meeting in Turkey, where Iran was criticized for supporting terrorism.

Second, while it is true that Saudi Arabia has begun to take a more nuanced position on terrorism emanating from Pakistani soil, it is unlikely that it can totally give up. In fact, a Saudi official categorically stated that the mention of terrorism in the joint statement with India was not aimed at Pakistan, but Iran.

Finally, the rights of Indian migrant workers have often been threatened and proven to be a sore point and recent oil price falls have further increased worries for Indian expatriates resulting in large number of workers been laid off and left in lurch by the Saudi Arabian government. This prompted the Indian government to chip in to support their cause. Furthermore, in October 2015, a woman from Tamil Nadu, Kasthuri Munirathinam, stated that her employer had chopped her hand off, after she tried to escape from the home where she was working. No action has been taken against the offenders. In December 2015, a video of three men from Kerala being beaten up severely by their employers was circulated, several trained electricians were fleeced by an employment agency and were forced to work in a brick factory (Haidar, 2015).

Recommendations

The first is the expansion of both economic and strategic ties which is already taking place. India and Saudi Arabia should widen their cooperation in the energy sphere to expand the scope of oil diplomacy through mutual investments in other oil and gas value chains and form an International Solar Alliance as discussed between the two countries through joint research and development in clean energy technologies.

Second other key stakeholders in the relationship such as the business community including Chambers of Commerce need to play a more pro-active role. Third, state governments including those such as Kerala, Andhra Pradesh which have close economic ties and significant diaspora populations in Saudi Arabia should play a greater role in the relationship. This is important not just in the context of attracting investment, but also addressing issues pertaining to Indian workers in Saudi Arabia. The central and state governments in India should work jointly to tap their diaspora in Saudi Arabia.

In conclusion, while there are strong strategic and economic imperatives for a strong New Delhi-Riyadh relationship, both the countries will do well to totally de-hyphenate the relationship from Pakistan and Iran. It would be a win-win situation for both the countries if they succeed in meeting their respective objectives of diversifying their economic portfolios through their respective vision and mission.

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THE ROLE OF FOREIGN CAPITAL IN THE ECONOMIES OF CENTRAL, EASTERN AND SOUTHEASTERN EUROPEAN COUNTRIES IN THE INTERWAR PERIOD

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Because of the acute shortage of capital and low investment rate in most Central, Eastern and South-eastern European countries, foreign direct flow played a crucial role in the economies of the region during the interwar period. As far as the serious consequences of First World War were concerned, the majority of the countries in the region with the exception of Czechoslovakia could stabilize their economies with the credits of the League of Nations and by foreign loans.

The objective of my essay is to analyse the share of foreign direct investments in the economies of seven Central, Eastern and Southeastern European countries (Austria, Hungary, Czechoslovakia, Poland and Yugoslavia, Bulgaria, Romania,) and to evaluate the political and economic motivation of the net creditors (Great Britain, France and United States). It also essential explain the statement of the literature, which emphasizes the economic backwardness of the region by the inadequate use of foreign loans and its high interest burden (between 7 and 10 percent). No doubt that after 1918 Central and Eastern European countries could get credits with unfavourable and politically motivated conditions in the international financial markets, but the foreign loans, which were given by the Entente Powers after First World War (Great Britain, France and United States) were spent not expediently but on luxury consumption and on repayment of interest burden of public debts.

However the share of foreign capital in strategic sectors (mining, industry and transport) reached between 50 and 80 percent in most of the countries of the region, it didn't promote the modernization of their national economies. During the interwar period Czechoslovakia was an exception, because as a net capital exporter it succeeded investing in Yugoslavia, Romania and Hungary. Because of lack of appropriate data one of the most difficult questions is to give a precise overview of the share of foreign direct investment in the national economies. According to the official position of national and international literature and available data also confirm that public loans surpassed the amount of foreign direct investments.

Because of the limited extent of this essay I will not deal with the theories, which emphasize the semi-peripheral development of Central, Eastern and Southeastern Europe and the consequences of its isolation from the world economy in the interwar period.

The role of foreign capital in the economies of Central, East and Southeastern European countries

Foreign capital played a crucial role before First World War in the national economies of Central, Eastern and Southeastern European countries. In order to better understand the flow of capital export, mention must be made to the changes, which happened in the position of net capital exporters after 1918. Before 1914 there were three important powers that dominated international capital markets: Great Britain, which had a foreign stock capital of 18 billion USD, followed by France with 8,7 and Germany with 5,6 billion USD. The United States used to be net debtor (Berend-Ránki, 1976, p. 316.). After 1918 significant changes happened in international financial markets. Germany as a defeated State lost its investments. Between 1914 and 1924 the foreign investment of France was reduced from 45 to 24 billion franc, which could be explained on the one hand by the loss of investments in Russia (The Bolshevik regime nationalized and confiscated all foreign holdings at the end of 1917) and on the other by financing the war expenditures through the sale of bonds. The increased risks on international markets and the unfavourable economic conditions hampered foreign direct investments, except for the years between 1924 and 1930. After the years of First World War Great Britain remained the biggest net exporter, but American capital export started to grow significantly and the United States jeopardised the position of British investors. As far as direct investments were concerned, American capital export mainly concentrated on Germany and Latin America, but for British investors the Commonwealth constituted the most important area of investment. China also became a crucial investment area, where Japanese and American capital had dominant position. Despite the unfavourable credit conditions in the second half of 1920s most of Central and Eastern European Countries were increasingly dependent on net capital import (Ripp, 1989, pp. 332-333.).

The United States and Great Britain became one of the most important creditors for the countries of Central and Eastern Europe in the interwar period. While the lack of capital remained a fundamental problem for most of the countries – except Czechoslovakia – in the region, Central and Southeast Europe was an important link in the chain of international economic relations. Capital export into this area was an integral part of Britain, France and the USA, which were politically, diplomatically and economically motivated. The Entente Powers followed two main objectives. On the one hand they wanted to eliminate the role, played by Germany as a significant trade partner in the region. This included the prevention of the renewed Mitteleuropa aspirations. On the other hand Central and Eastern Europe was handled as a barrier – cordon sanitaire – against the Bolshevik regime of Soviet Russia (see more: Teichova, 1997, p. 9.).

The changes, which took place in international financial markets influenced the economic life of Central and Eastern European Countries significantly, which were dependent largely on capital imports. For instance, before the First World War Austria used to be net capital exporter and importer as well, but after 1918 the country became a net capital importer (Berend-Ránki, 1976, p. 316.).

These circumstances had profound impacts on the positions of net creditors and net capital importers. It must be stated that as a consequence of acute shortage of capital most of countries in the region – except Czechoslovakia – could stabilise their economies by the credits of the League of Nations. Thus stabilisation served the creation of optimum economic conditions, which was necessary for domestic accumulation. The seriousness of shortage of capital was shown by the fact that in the later 1920s the level of domestic accumulation remained well below the pre-war level. In Hungary, for example domestic accumulation averaged only 5-6 per cent of national income compared with 10-15 per cent before the war and even in the peak year the proportion was still only 8 per cent. In the Balkan countries the shortfall was even worse (Aldcroft, 1995, p. 52.). This problem was exacerbated by the deflation policy, which caused a permanent shortage of money and made borrowing costs very high.

Because domestic resources weren't enough to cover the expenditures of the budget and to develop the national economy, a large quantity of foreign capital was needed for most of the countries of the region. In the 1920s large quantities of loan capital were flown in to the east-central and south-east European area (Palotás, 2003, p. 242.). Much of it was designed to help with relief, immediate reconstruction and later stabilization of currencies and little went into productive enterprises (Aldcroft, 1995, p. 52.).

Austria after receiving of 650 million gold crown foreign loan by the League of Nations it didn't received long-term credits for a long time, however external borrowings played an important role in the domestic economy of the country. Foreign loans not only served economic and financial stabilisation, but also productive investments as well. Sixty-three per cent of external borrowings were used to achieve the balance of the budget and 37 per cent went into state investments in order to cover their capital needs. The latter, which was 323 million schilling contributed to finance the electrification of railways in the Alpine country. In 1930 Austria was granted 725 million schilling foreign loan at rate of interest of 7 per cent by English and American financial groups within the framework of the International Bank for Settlements. In June 1930 the first block of oversees borrowing was issued at exchange rate of 91 per cent, which was equivalent to 394.8 million schilling. It must be emphasized that as a consequence of the economic and financial crisis the next issue of external bonds was later postponed (Berend-Ránki, 1976, pp. 317-318.).

Parallel with public loans in 1922 and 1930 significant short-term borrowings went into the domestic economy, especially in the form of commercial credits. The latter reached 1.3 billion schilling and contributed to the modernization of Austrian industry (Berend-Ránki, 1976, p. 318.).

The public debt of Austria – taking into account of the international credit financing aids, which went up to 800 million and the pre-war debt service of 1 billion schilling – reached 4.251 million schilling in 1932. Long-term loans constituted 2.575 million, while medium- and short-term accounted 384 and 1.287 million schilling. Short-term loans averaged about quarter of the Austrian total public debt, but after 1918 they contained half of the post-war borrowings (Berend-Ránki, 1976, p. 318.).

After 1923, when Hungary was granted foreign loan of 650 million crown by the League of Nations, the country didn't receive new credits. The financial operations started by issuing of the mortgage-bond for 35 years at rate of interest of 7.5 per cent through the Hungarian Land Credit Institute in London. In 1925 the minister of finance of Hungary concluded a 10 million USD loan contract on behalf of 48 Hungarian cities by the American bank Speyer&Co. for 35 years at rate of interest of 7.5 per cent. 2.5 million pound foreign loan was given by an English financial group to the Hungarian counties for 20 years at rate of interest of 7.5 per cent for road reconstruction. In 1926 32 Hungarian towns received foreign borrowing for 20 years at rate of interest of 7 per cent from the same American financial institute. In 1928 another 3,3 million USD long-term foreign loan contract was signed between the English Talbot Company and Hungary, which allowed for the construction of the power plant in Bánhida near Tatabánya that supplied Budapest with electricity, and the electrification of railways between the capital of the country and Hegyeshalom. The largest sum of foreign borrowing (36 million USD) was granted by the Swedish Match Corporation to the Hungarian State for 50 years at interest rate of 5.5 per cent and exchange of 92 per cent in order to indemnify the landlords as a consequence of the confiscation of the Nagyatádi's land reform.

Because of the monopolistic position of the Swedish Match Corporation on the Hungarian market, provided by the state, the price of the matches increased threefold (Draskóczy et al., 1998, p. 347.).

In Hungary until 1929, when the economic and financial crisis broke out, private companies, churches, municipalities and the central government got 1.9 billion pengő in long-term and short-term loans. Taking into account the pre-war loans, the debt service of the country went up to 3.5 billion pengő in Summer of 1932 (Romsics, 1999, p. 156.).

In Yugoslavia financial operations started in 1922 by the issue of a short-term American loan. This was followed next year by 300 million French franc and American borrowings. In 1928 the Balkan country received a Swedish foreign loan. A stabilization loan (1.025 million French franc) was also granted to Yugoslavia in 1931, which was followed by the issue of short-term credits by the French treasury. Taking account of American, French and Swedish borrowings, which served the modernization of transport and the purchase of armaments, 6.7 billion dinar in long-term foreign loans were granted to the Yugoslav state. It must be noted that in the second half of 1920s the sum of short-term loans also increased. The total debt burden of the country was even higher (Palotás, 2003, p. 243.). In the middle of 1932 the external debt service of Yugoslavia was 32.8 billion dinar, which meant that the commitments of foreign debt service constituted one-third of the export receipts (Sundhaussen, 1987, p. 910.).

State loans didn't play a significant role in Romania, especially during the liberal governments. However the post-war debt service increased as a consequence of the foreign borrowing of 175 million USD in1922, but it was converted into external Romanian treasury bills. Until 1929 there weren't any new financial operations. In the same year the Peasant Government of Romania made an economic turn and decided to borrow 100 million USD, and later 1.3 billion French franc for productive agricultural investments (Palotás, 2003, p. 243.). The foreign debt of the Balkan country increased from 2.9 billion lei in 1921 to 141 billion in 1933, decreasing to 80 billion lei in 1938. Between 1922 and 1940 the transfer across the borders of profits and capital, together with the annuities on foreign public debt rose to 406 billion lei, 13.4 per cent of the national budget, the largest state budget in the inter-war period (Bolovan et al., 1996, p. 409.).

If we do not take into account the Stabilization Loans, the inflow of foreign capital was not significant in Bulgaria. Because of conversion of pre-war credits the debt service increased in the Balkan country. As a consequence of the reparations of the Treaty of Neuilly (2.25 billion gold franc) and other commitments the external debt of the country increased up to 140 million USD in 1932. One-third of the debt service originated after the post-war years. Foreign capital flew mainly into the Bulgarian private sector (Palotás, 2003, p. 243.).

Because of domestic accumulation and economic development of Czechoslovakia, the country was less dependent on capital imports as compared to Southeast European states. Public loans were granted after post-war years. At first, in 1922 a 50 million external loan was given to the Czechoslovak economy by Great Britain, which served private investments and food supplies. In the same year, American and English banks granted 15 million USD borrowing to Prague for the extension of the city's electricity network. Czechoslovakia used to be an exception in the region, because it succeeded in covering 75 and 80 per cent of the public loans by domestic accumulation, and the percentage of external borrowings was only 20 and 25. If short- and long-term loans were taken account, Czechoslovakia belonged to the net capital exporters, but in the 1920's the external debt service of the Czechoslovak state was reduced significantly by the buying back of external shares and bonds (Berend-Ránki, 1976, pp. 322-323.).

The sum of external loans was negligible in the Polish economy. Until 1923 only 151 million USD capital flew into the country. Afterwards until the deepening of economic crisis an additional 350 million USD state loan was given to Poland to stabilise the state finances. From 1927 the balance of trade was covered by external loans. Most of the borrowings were short-term and were granted by unfavourable conditions (Palotás, 2003, p. 243.).

During the inter-war period the indebtedness of Central and Eastern European Countries remained a crucial and unresolved problem. However indebtedness for each of the six countries. “The more than $700 mn owed by Hungary represented $83 per head of population, and its annual service of $48 mn claimed 6 per cent of national income and as much as 48 per cent of export receipts (1931). The external debt of Romania, of more than $1,000 mn, was of $56 per head, and its service required 8 per cent of national income and 36 per cent of exports. The debt service of Yugoslavia's external debt (which, in comparison with Romania's, showed, most likely, a lower total and an about equal amount per head) demanded $30 mn, or 5 per cent of national income, but equally 36 per cent of exports" (Nötel, 1986, p. 224.).

"The burden of the external debt and debt service was much less heavy for Poland and Bulgaria: it reached $20-30 on a per capita basis and aid claim to 3 per cent of national income and 20-30 per cent of export receipts. The debt service for Czechoslovakia represented no more than 1 per cent of national income and 5 per cent of export turnover" (Nötel, 1986, p. 224.).

Table 1. External debt and debt service 1931 or 1932

	External debt		External debt service		
	Mn $	$ per head of population	Mn $	Percentage of national income	Percentage of merchandise exports
Bulgaria	138	23	10	3	22
Czechoslovakia	393	27	22	1	5
Hungary	728	83	48	6	48
Poland	860	27	58	3	27
Romania	1016	56	52	8	36
Yugoslavia	631	45	30	5	36
Total of six countries	3766	40	220	3	23

Source: Kaser, M. C. – Radice, E. A. (1986): The Economic History of Eastern Europe 1919-1975 Vol II. Oxford, Clarendon Press, p. 223.

The major part of total debt burden, 2.100 million USD equivalent to 55 per cent originated not from the post-war but from the pre-war and war-time period. The share of pre-war and war debts of the Austro-Hungarian monarchy and of Romania, Yugoslavia (Serbia) and Bulgaria, debts contracted in the war-time period or related to the peace treaties, consisted of more than 70 per cent of the total debt in Czechoslovakia and Yugoslavia and more than 60 per cent in Romania and Bulgaria. Only in Hungary and Poland was their share much below the average of the six countries (34 per cent and 42 per cent, respectively) (Nötel, 1986, p. 224.).

Table 2. Pre-war and post-war external debt 1931 or 1932

	Pre-war debt (Mn $)	Post-war debt (Mn $)	Percentage distribution pre-war debt	Percentage distribution post-war debt
Bulgaria	89	49	65	35
Czechoslovakia	279	114	71	29
Hungary	248	480	34	36
Poland	359	501	42	58
Romania	645	371	64	36
Yugoslavia	458	173	73	27
Total of six countries	2078	1688	55	45

Source: Kaser, M. C. – Radice, E. A. (1986): The Economic History of Eastern Europe 1919-1975 Vol II. Oxford, Clarendon Press, p. 224.

It must be noted that post-war debt of $1,700 mn was equivalent to 45 per cent of the total debt of the region. Debts, which originated from the loan and credit transactions of the post-war period amounted to about $500 mn in Poland and in Hungary; to nearly $400 mn in Romania; to nearly $200 mn in Yugoslavia; to about $100 mn in Czechoslovakia; and to about $50 mn in Bulgaria (Nötel, 1986, pp. 224-225.).

The importance of capital import dependency of the Central and Eastern European countries was shown by the fact that during the interwar period, the sum of external borrowings exceeded the inflow of capital. Analysing the standpoint of the literature (see Berend-Ránki, 1977; Aldcroft, 1995 and Teichova, 1997.) the question arises why the external loans didn't promote the economic development of the region. Most of authors emphasize the differences of general economic conditions, namely that the dynamic growth in first half of 20th century came to an end after the post-war period. The moderate economic take off lasted until the economic and financial crisis broke out in 1929. It must be noted that borrowing costs were both very high and inflexible. While before 1914 borrowings were granted at rates of interest of 3-4 per cent, they were between 7 and 10 per cent after the post-war period, which could be explained by the unfavourable economic conditions. Because of the nominal value of external loans the high level of issue and the transmission of exchange rates provided 11-12 per cent benefits for the creditors. This meant a huge burden on the national economies of the countries in the region and led to a rising burden of debt and servicing costs. The sum of external loans was irrelevant high both to the bearing of national economies and to the allocation of its resources (see more: Berend-Ránki, 1976, p. 324.).

The main problem was that only a small proportion of external borrowings went into productive companies or into activities that would generate immediate exchange earnings. By the far larger part of the proceeds were used for financing non-essential imports and social infrastructure investment, the accumulation of private balances abroad, and the payment of interests and dividends. It must be noted that the flow of foreign capital was unstable, a significant part of it contained short-term funds. It was generally believed that to attract foreign investors sounds deflationary policies were necessary to ensure that external balances were adequate for the future of debt services. Such policies aggravated the economic situation of Central and Eastern European countries and had negative impacts on domestic capital formation. Finally this economic policy also hampered the structural diversification of the economies of the region and resulted in high comparative costs (Aldcroft, 1995, pp. 53-54.).

There are precise calculations for the use of overseas borrowings in Hungary. According to estimations of Berend and Ránki 20 per cent of foreign capital went into productive investments, 15 per cent was invested in social infrastructural projects and educational purposes by the municipal governments, and finally 40 per cent was used for repaying former debt service including some dating from before the war. In compliance with several studies, published by the Royal Institute of International Affairs, the same tendencies could be seen in other Central, Eastern and Southeastern European countries (Berend-Ránki, 1987, p. 809.). The use of capital inflows was probably no better in Poland and the Balkan countries. One-quarter of Romania's foreign loans served the wasteful consumption on estates and the civil service. Between 1924 and 1928 $604 million long- and short-term capital flew into Hungary, Bulgaria, Yugoslavia and Poland. One half of the borrowings contributed to finance the surplus of goods and services, one-tenth was used for the purchase of gold, while the remaining two-fifths provided for the exchange requirements to meet interest and dividend payments (Aldcroft, 1995, pp. 54-55.).

After World War I. political factors, such as diplomatic influence by creditor nations, often determined official loan policy. The interests of lenders were minor in investments of the domestic economies of the region. According to estimates the total amounts of foreign direct investments in East Central Europe were significant lower than the sum of state loans (Palotás, 2003, p. 244.). In the beginning after the postwar period the main creditor nations (United States and Great Britain) didn't strive to achieve strategic positions in the domestic economies of the area. Before World War I. Germany and France held equity shares in the banking and industrial sector. Because Germany was a defeated nation after 1918 according to the Versailles Peace Treaty, in which it was undertaken to make compensation for all damages for the Entente Powers, the country lost its shares of capital and positions (60 per cent of its investments were confiscated by the victorious powers) in Central and Eastern Europe. As a consequence of the permanent remonstrance by France and Great Britain against the German expansion in the region as a whole, the endeavours of Germany to regain its political and economic influence in Central and Eastern Europe was partially successful. After

1923, when the Ruhr crisis broke out, the role of German capital was reduced to minimum (see more: Berend-Ránki, 1976, pp. 326-327.).

In the immediate post-war years French financial groups acquired key positions in the economies of Central and Eastern European countries. French holdings had already obtained influence in the region before World War I. Alice Teichova states in the Cambridge Economic History of Europe that "France's preoccupation with security and military prestige in Europe intensified her awareness that her economic position was substantially weaker than that of her Anglo-American Allies, particularly in the area of international investment. Therefore, her capital export aimed to close any permanent ties of receiving countries with her own economy. Between 1919 and 1921 the French government encouraged leading business groups to obtain strong positions in those east-central European countries which were traditionally francophile by securing permanent participation of French concerns in enterprises, which dominated the economy of these countries. Thus France's endeavours to acquire key positions in banking and heavy industry of the successor economies and to strengthen her hold over these states by military alliances arose out of her comparatively weak position among the victorious powers and were not only directed against potential German but also actual allied, particularly British competition in this area" (Teichova, 1989, pp. 914-915.).

The leading French iron and steel producer holding, Schneider et Cie, Creusot acquired strategic positions in Czechoslovakia, Poland, Hungary, Romania and Yugoslavia. It succeeded obtaining 73 per cent participation in the capital of the Škoda-Works in Plzeň in September 1919, followed by the purchase of a majority of holding in the second largest iron and steel combine in Czechoslovakia, the Baňská a hutní splečnost (Mining and Metallurgy Company) in Třinec (Teichova, 1989, p. 920.). Controlling positions in the coal, steel, and engineering industries of Poland were held by a number of French firms, including Skarboferm, the Schneider concern, the Société des Charbonnages, mines et usines de Sosnowice. For instance, in Hungary 24 percent of the shares of Hungarian General Credit Bank were acquired by Schneider Creusot. In Romania the influence of French financial groups was shown by the purchase of shareholdings. The equity share of France in the Romanian oil industry increased from 5 to 16 per cent in 1931. The leading copper mine of Yugoslavia was owned by the local subsidiary of Société Mirabaud, Puerari et Cie, Paris (Nötel, 1986, p. 284).

It must be emphasized that behind the French intentions, an important objective of national diplomacy was to establish the continental hegemony in Europe both economically and politically. This standpoint was endorsed by the State Secretary of Foreign Affairs of France, Maurice Paléologue, who wanted to create a Polish-Hungarian and Romanian block as a reliable alliance for the West European country. In the case of Hungary he suggested a high volume of French investments (see acquiring the shares of MÁV, building of a free port in Csepel and purchase of the sharing in Hungarian banks) and advised to be a mediator between Czechoslovakia and Hungary in order to mitigate the injustice caused by the Treaty of Trianon. The project, which was originally based on the assumption that France would play a crucial role in the reconstruction of national economies of the Central and Eastern European countries finally failed. Not only Hungary, but also other states in the region (Czechoslovakia and Romania) refused the plan of Paléologue. Moreover Great Britain opposed the French initiative, which could jeopardise the balance of power in Europe (see more: Ormos-Majoros, 2003, p. 294.).

Italy as a successor nation in World War I. used out the weakening of Germany's position in Central and Eastern Europe and strived to increase its influence in that area. For instance, the Company of Fabank and the Yugoslav OFA holding, which comprised 32 different timber industries in Transylvania and Croatia were purchased by the financial group, Banca Comercial Italiana. The Hungaro-Italian Bank was established in 1920 by the acquisition and merger of the Hungarian Timber-merchant Credit Institute and the Hungarian General Credit Bank. The Italian banking sector played an active role in the textile industry of Łódž and also in the Polish financial sector. The invested capital of Italy was 5 per cent in Bulgaria (Berend-Ránki, 1976, p. 329.).

Great Britain also showed increased economic interest in East-Central and Southeast Europe, which originated from her generally changed position in the world economy. The main objective of British capital export to the region was to open up or expand formerly neglected markets for British goods. The British government and its diplomats gave ample political support to those businessmen and bankers who were interested in investment in the Danubian basin. They thought that capital injections from Britain were essential in order to help rebuild trade connections. Taking account of British economic policy and interest in Central and East Europe, Great Britain played a leading role in the economic life of the region after the postwar period (see more: Teichova, 1989, p. 915.). In the national economies of East-Central and Southeast European countries not only British, but also American capital investments (mainly in the form of acquiring of shares and establishment of joint-stock companies) played an important role. "The giants of the electrotechnical industry in the United States, International General Electric Co., Westinghouse Electric and Manufacturing Co., and International Telephone and Telegraph Co., and some of their main partners in the United Kingdom (English Electric Co., Standard Telephones and Cable, Ltd.), Germany (AEG, Siemens), and France (Als Thom), controlled a closely-knit network of subsidiary and cooperating companies, centred on Czechoslovakia, Poland, and Hungary, but extending also to Romania and Yugoslavia" (Nötel, 1986, p. 284.).

The British banks (British Overseas Bank, N. M. Rothschild and Anglo-International Bank, London) had widespread interests in the region and were intertwined with banks and industrial companies in Czechoslovakia, Poland, Hungary, and Yugoslavia. Behind the influence of Great Britain in the banking sector, one of the most influential British groups in shipbuilding, insurance and banking, The River Syndicate Ltd, started negotiations first with the Austrian Federal Chancellor, Dr. Renner, and the influential banker, Dr. Sieghart, then with the Hungarian and later Romanian and Yugoslav government and banks. The result of negotiations was the creation of the Danube Navigation Company Ltd in March 1920, which had capital of £1,200,000 in London, which held the shares acquired from the shipping companies in Regensburg, Vienna, and Budapest together with their interests in other Southeast European Danube shipping enterprises (Teichova, 1989, p. 919.).

Important positions were held by British companies in the iron, steel and chemical sector. For example, the Nobel Industries Ltd., London and Société centrale de Dynamite, Paris, controlled important parts of nitrogen and explosives production in Czechoslovakia, Poland and effectively also in Romania and Yugoslavia (Nötel, 1986, p. 284.). The share of British capital in the oil industry of Romania increased from 6 to 10 per cent. In Poland 13 per cent of foreign capital stock in the banking sector was in the hands of British financiers and the invested American capital in joint-stock companies accounted for 22 per cent in the oil and zinc industry (Berend-Ránki, 1976, p. 330.). In the Yugoslav mining and metallurgical industry of the inter-war period British capital held first place with 45 of the total direct investment. Although British capital participated relatively little in direct investment in Bulgaria, it didn't withdraw at the end of the 1930s but, on the contrary increased its share by investing in gold-mining (Zlata) and in establishing a food tinning factory (Poels) between 1936 and 1937 (Teichova, 1985, pp. 222-323.).

Besides external loans, which were granted to the Central, Eastern and Southeastern European countries, foreign direct investments still played an important role in financing of the national economies of the region. Except for a short period between 1918 and 1919, foreign capital was essential to modernise the economies of the countries in East-Central and Southeast Europe.

One of the most difficult tasks is to determine the precise share of foreign direct investments in the economies of Central and Eastern European countries. Derek H. Aldcroft states in his book (Economic Change in Eastern Europe since 1918, Edward Elgar Publishing Limited, Aldershot, 1995) that "In most countries apart from Czechoslovakia, which for most of the time was a net creditor, foreign capital amounted for 50-70 per cent of the financing of their economies. In Hungary foreign capital was about equal to domestic accumulation, while in Poland the ratio of domestic to foreign capital was 4:6, with nearly 40 per cent of the total capital of joint-stock companies being of foreign origin. Foreign participation was even higher in Bulgaria and Yugoslavia: in the former case 72.3 per cent of the national debt and 48 per cent of equity capital was owned by foreigners, while in Yugoslavia the respective shares were 82.5 and 44 per cent" (Aldcroft, 1995, p. 53.).

Foreign capital, however played a crucial role even in the most advanced countries of the region. The composition of capital stock in Czechoslovakia changed significantly after 1918. The Austrian and German industrial and financial groups were squeezed out by leading financiers of Great Britain, France, Belgium and the United States. One-quarter of the Czechoslovak economy was owned through shares of capital by foreign investors. The interests of British, Belgian, Dutch and French investors were manifested in joint-stock companies. At the end of 1937, 27 per cent of the capital stock of Czechoslovakia was in the hands of joint-stock companies. The preponderance of foreign capital prevailed in heavy industry. In mining, iron and steel production, 64 percent of the total capital stock was of foreign origin. In these above mentioned strategic sectors British and French joint-stock companies had dominant positions, but foreign interests were significant in the chemical and electrical engineering (Teichova, 1987, p. 612.).

Czechoslovakia was an exception in the inter-war period because the country was herself an exporter of capital. Her capital turnover showed a credit balance between 1925 and 1937, except for the years of the crisis. Czechoslovakia had considerable foreign investments, which accounted for 12 per cent of all the foreign investments in Yugoslavia, and 5 per cent of all in Bulgaria. She also had interests in Hungary and Romania (Berend-Ránki, 1977, p. 100.).

In the moderately advanced countries of the region, foreign capital played a much more important role. Of the four big banks in Hungary, one-fifth of the shares of the leading Hungarian General Credit Bank was controlled by French and Austrian financial groups. The participation of British and Italian capital was significant in the Hungaro-Italian Bank as well as in the Anglo-Hungarian Bank. Despite the takeover of industrial firms by Hungarian companies in the twenties, and the purchase of considerable packets of shares from Austrian owners in the 1930s, and even after the failure of Creditanstalt-Bankverein in 1938, 24 per cent of Hungarian industrial shares were owned by foreigners, half of them German investors

(Berend-Ránki, 1987, p. 799.). In Poland, foreign investors played a dominant role in heavy industry. The preponderance of foreign direct participation prevailed in some strategic sectors. In the late thirties, slightly more than 40 per cent of the total capital stock of joint-stock companies was owned by foreign financiers. They held several key positions. In mining and metallurgy, 26 firms working with foreign capital held 71 per cent of the total capital. In the oil industry, 17 firms controlled 87 per cent of the total capital; in the electrical industry 18 firms held 55 per cent; and in the chemical industry, 59 firms 60 per cent. Approximately 30 per cent of the capital invested in telecommunications, and 46 per cent of the capital used for electric power plants, gas production, and hydroelectric power plants originated from foreign investments.

Table 3. Origin of foreign investments in joint-stock capital of Czechoslovakia, Poland, Bulgaria, and Yugoslavia, 1937 (percentages)

Country of origin of foreign investment	Czechoslovakia	Poland	Bulgaria	Yugoslavia
Great Britain	30,8	5,5	1,1	17,3
France	21,4	27,1	9,2	27,5
Austria	13,1	3,5	-	-
Holland	8,8	3,5	0,4	2,1
Germany	7,2	13,8	9,3	6,2
Belgium	7,1	12,5	20,5	5,3
Switzerland	4,5	7,2	25,1	7,3
United States	3,5	19,2	11,1	12,0
Italy	2,2	-	13,2	3,1
Sweden	0,9	2,7	2,3	1,2
Hungary	0,5	-	-	2,0
Czechoslovakia	-	1,6	2,3	8,5
Other countries	-	3,4	7,4	-
Monaco			0,4	2,9
Poland				0,3
Liechtenstein				0,3
Luxemburg				0,5
Swiss mixed capital				2,6
Anglo-Dutch capital				0,8
US-French capital				0,1
Total	100	100	100	100

Source: Teichova, A. (1989): East-central and south-east Europe, 1919-1939. In: The Cambridge Economic History of Europe, Volume VIII. (Edited by Peter Mathias – Sidney Pollard). Cambridge, Cambridge University Press, p. 923.

The largest proportion of foreign capital (27 per cent), which was invested in Polish joint-stock companies belonged to French financiers. American financial groups held second place (19 per cent); followed by Germans with their share of 14 per cent, and by Belgians, with 13 per cent (Berend-Ránki, 1977, pp. 100-101.).

Foreign capital played a crucial role in the least developed Balkan countries. For instance, in Romania almost the entire oil industry was owned by foreign investors. Despite state incentives, which increased the interests of national entrepreneurs, 75 percent of invested capital was in the hands of foreign financiers. 40-50 per cent of the invested capital stock concentrated on the oil industry (Palotás, 2003, p. 245.). In certain industries, such as coal mining and chemicals it retained a dominant place. Yet the decade between 1929 and 1939 foreign participation in heavy industry declined from 70 to 40 per cent and in the economy in general from 65 to 38 per cent. French and English capital preserved its dominant role. Germany wanted to recover something of her pre-war position, especially in oil and mining (bauxite and chromium), because of their military uses, but she had little success in penetrating these branches of the Romanian economy until after September 1940 (Hitchins, 1994, p. 375.).

During the interwar period, Yugoslavia, which was a backward country both economically and industrially needed to have sufficient capital import. There are different calculations for the invested foreign capital in the national economy of the Balkan country. The invested capital in joint-stock companies used to be between 2,2 and 2,9 billion dinars in the post-war period. According to the estimations of Dimitrijevič the total invested capital in joint-stock companies – except for credits and capital surplus – reached 3,9 billion dinars, which accounted for 62 per cent of the total capital stock of Yugoslavia. The largest investors were Great-Britain (760 million dinars) and France (648 million dinars), followed by Germans with investments of 598 million dinars. If external loans, capital surpluses and foreign direct investments are taken into account in the invested capital of joint-stock companies, then the amount of foreign capital surpassed that of 10 billion dinars (Sundhaussen, 1987, p. 909.).

The Yugoslav economy was intertwined with foreign financiers. Lampe and Jackson emphasize in their book Balkan Economic History, 1550-1950 the following: "Over two thirds of the Yugoslav production of cement, sugar, and electricity was in the hands of foreign stockholders. The mining and processing of nonferrous ores remained overwhelmingly in British and French hands until after the Second World War had started. Their combined share of foreign investment in Yugoslav mining was nearly 90 per cent in 1937. The controlling French interests in the Bor copper mining and smelting complex added an electrolytic converter to remove gold and silver in 1938" (Lampe-Jackson, 1982, p. 517.).

Because of industrial underdevelopment and shortage of raw material, foreign capital did not acquire significant positions in Bulgaria. Only 26 per cent of industrial capital stock was in foreign hands in 1921, and by 1938, this had fallen to 18 per cent. However, certain foreign financial groups had important influence in the Bulgarian banking sector (see more: Berend-Ránki, 1977, p. 101.).

Summarizing the experiences of foreign direct investments in East Central Europe during the interwar period, we have to state that foreign capital still played a crucial role in the national economies of the region. As a consequence of lack of domestic accumulation, all countries of the area needed sufficient financial resources for their economies. In the 1920's large sum of public loans went into the countries of East Central Europe, while foreign direct investments were negligible. A negative characteristic of the postwar period was that borrowing costs were very high (at rates of interest between 7 and 10 per cent) (Domonkos, 2016, p. 239.).

Conclusion

As far as the role of foreign capital in the national economies of Central and Eastern European countries was concerned, three important issues had to be underlined:

1. The share of foreign capital in the postwar period was well below the level before World War I. The amount of foreign direct investment was lower than public loans. Despite these facts,

foreign capital accounted for 20 to 75 per cent in strategic economic sectors such as the mining industry and transport. This clearly shows that the majority of the countries of the region depended on capital import.

2. The amounts of external borrowings exceeded the volume of capital import before 1914. The main problem was that foreign loans didn't contribute to the modernization of national economies, but a large part of them (40 per cent) were used for repaying former debt service and interest payments. Twenty-five per cent of borrowings went into consumption. It must be noted that in the majority of the East-Central and Southeast European countries, debt service constituted a significant part of export earnings. In order to reduce indebtedness, productive investments should have been made in order to increase productivity and efficiency but the problem was that they failed completely. The seriousness of the situation was shown by the fact that in 1928, Bulgaria claimed that 12,3 and Romania 14,6 per cent of their export receipts went to repay the interest payments on their national debts. This ratio was the same in the case of Hungary and Yugoslavia 17,9 and 18,1 per cent (see more: Hösch, 1993, p. 217.). One of the crucial problems was that foreign loans weren't used efficiently in the national economies of the region. The consequence was that foreign capital couldn't improve the one-sided and distorted structure of the economies East Central Europe.

3. The highest volume of capital import went into the region in the second half of 1920s. Capital inflows lasted only for a short period until the economic and financial crisis broke out in 1929 (Palotás, 2003, p. 245.). Another problem was that a significant part of foreign capital consisted of short-term funds, and served only for speculative purposes, which exacerbated the financial vulnerability of Central, Eastern and Southeastern Europe.

Taking into account of the above mentioned conclusions, foreign capital didn't solve the main structural problems of the economies of the region (see the case of dual economy and low level of domestic accumulation), moreover its unproductive use contributed to the economic backwardness of East Central Europe.

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THE MAIN CONTEXTS IN CROSS TAIWAN STRAIT RELATIONS

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The current paper strives to provide a short, yet comprehensive overview of Cross-Strait relations within a multilateral framework that, to a limited extent, includes the Republic of Korea and Japan. The primary purpose of the current paper is to set a base for further research at the Budapest Business School on Taiwan's economic advancement, its political environment and the implications of those for European and other regional players, therefore significant emphasis is placed on the contextual parts of the relationship. The contexts include historical, (geo)political as well as economic approaches at the same time, however, those are limited in volume and scope to the extent regarded necessary to provide crucial theoretical background for the interpretation of current Cross-Strait processes, and determining regional phenomena such as the emergence of the concept of developmental state. The contexts are inseparable from each other, and together they form the base pillars of the framework the paper strives to draw up. Emphasis is put on political to economic contexts.

The major context is *time*. After the Introduction, the paper is divided into three chapters that break down according to a historic division: the pre-1949 period (1), the Cold War era (2), and the new era starting from the early 1990s (3). The first chapter provides historic, geopolitical and political background for the Cross-Strait relationship. The second chapter deals with the core relation from a broader geopolitical perspective while also making competitive comparisons of the rise of US-allied states in the East Asian economic space–i.e. Japan, Republic of Korea–whereas the third chapter aims to reveal the major trends, developments, and forces currently shaping the future of the Cross-Strait relations. Because the main purpose of the current paper is to establish a ground for further research at Budapest Business School, the paper is primarily descriptive in a contextual way. Based on the contextual chapters, however, three assumptions are also drawn up in Chapter 3, that point out potential directions for further research. A short Conclusion concludes the paper.

Contexts

None of the entities of East Asia today enjoys a thorough political independence and economic self-sufficiency. Not even North Korea does. The countries of the Far East in the 21st century share a common faith so closely intertwined as never before known in history. But the more tightly economic interdependence is linking the entities in the region together, the more unhealed past wounds seem to be hurting these relationships, that in turn entails different forces working towards the opposite direction: separation. In the very heart of this intertwining East Asian room we find the core relationship examined by the current paper. In order to fully grasp the importance and nature of Cross-Strait relations as well as the larger Far Eastern region and those counter-moving forces working beyond, major historical formations of integration and separation have to be pointed out. In the first part of this chapter a short contextual introduction of classical China-centred East Asia is made. The second part deals briefly with how the appearance of aggressively pushing European powers reshaped the classical East Asian geopolitical constellation, while the third part describes how Japan tried and failed to take control over the entire region with fading European influence. Taiwan's role is highlighted throughout the chapter.

The Confucian Civilization – Cultural Context

The cultural and economic unifying force of the East Asian space had been imperial China for approximately two millennia. Imperial China had been the centre of a wide tributary system that (periodically) encompassed an area stretching from the Strait of Malacca through Himalayan states to Japan (Andornino, 2006, pp. 15-16). The system–dating back to the Han dynasty over 2000 years ago–was built on the basis of trade links, but it had worked as the transmitting network of culture, too (Zhang, 2013). Since the island of Taiwan was inhabited by hostile tribes and possessed only scarce resources for trade through the 16th century, the island had never been a part of the Chinese tributary system (Chang, 2011, pp. 80-82.).

It was not until the late 17^{th} century that China's Qing-dynasty officially annexed the island and incorporated[1] it in the Chinese empire. Settlers from predominantly the southeastern province of Fujian gradually squeezed out the indigenous tribes to the Western and mountainous parts of the island (Copper, 2007, pp. 53-54; Olds 2008).

If we widen our geographical scope to include Japan and Korea as well, in an 18^{th}-19^{th} century map we can see the last peak–before major Western intrusions–of Chinese cultural and socioeconomic dominance in East Asia. Taiwan was getting gradually incorporated in the ecosystem of the Qing-empire, although riots and rebellions often accompanied the process. The Korean peninsula was a stronghold of the China-centred tributary system and Neo-Confucian administration, as Edo-Japan chose a self-imposed isolation policy. While Neo-Confucianism was the official guiding philosophy of the Edo(/Tokugawa) Japan (Encyclopaedia Britannica, 2016b), views of Japan being traditionally more Confucianist than China became popular (Tsutsui, 2009, p. 106). Confucianism had undoubtedly been the single most powerful ideological school that deeply influenced all the major Far Eastern states and left them with deeply rooted social, cultural and political similarities.[2]

<table>
<tr><td colspan="4">Table 1. The Far East in the 18th-19th century</td></tr>
<tr><td colspan="2">The Far East in the 18^{th}-19^{th} century</td><td>Tributary</td><td>(Neo-)Confucianism</td></tr>
<tr><td rowspan="2">Qing-China</td><td></td><td colspan="2">“Mandate of Heaven”, Neo-Confucianism as official state ideology</td></tr>
<tr><td>Taiwan</td><td colspan="2">Gradual incorporation, Chinese customs, strengthening trade links with the mainland</td></tr>
<tr><td colspan="2">Joseon-Korea</td><td>Multiple times annually, flourishing trade</td><td>Official state ideology, branches of Buddhism tolerated</td></tr>
<tr><td colspan="2">Edo-Japan</td><td>No more tributary missions to China neither from the Emperor's side nor from any of the shoguns</td><td>Official guiding philosophy with Ten Buddhism and Shintoism having strong influence on the way of thinking as well</td></tr>
<tr><td colspan="4">Source: own compilation</td></tr>
</table>

[1] The term incorporation is important as the island not only became a territory of the „middle kingdom", but also became an extension of its cultural might.

[2] China was civilization itself, and Confucianism was what made it so — “perhaps the most powerful political ideology yet conceived by the human race,” writes Watanabe. (Hoffman 2013)

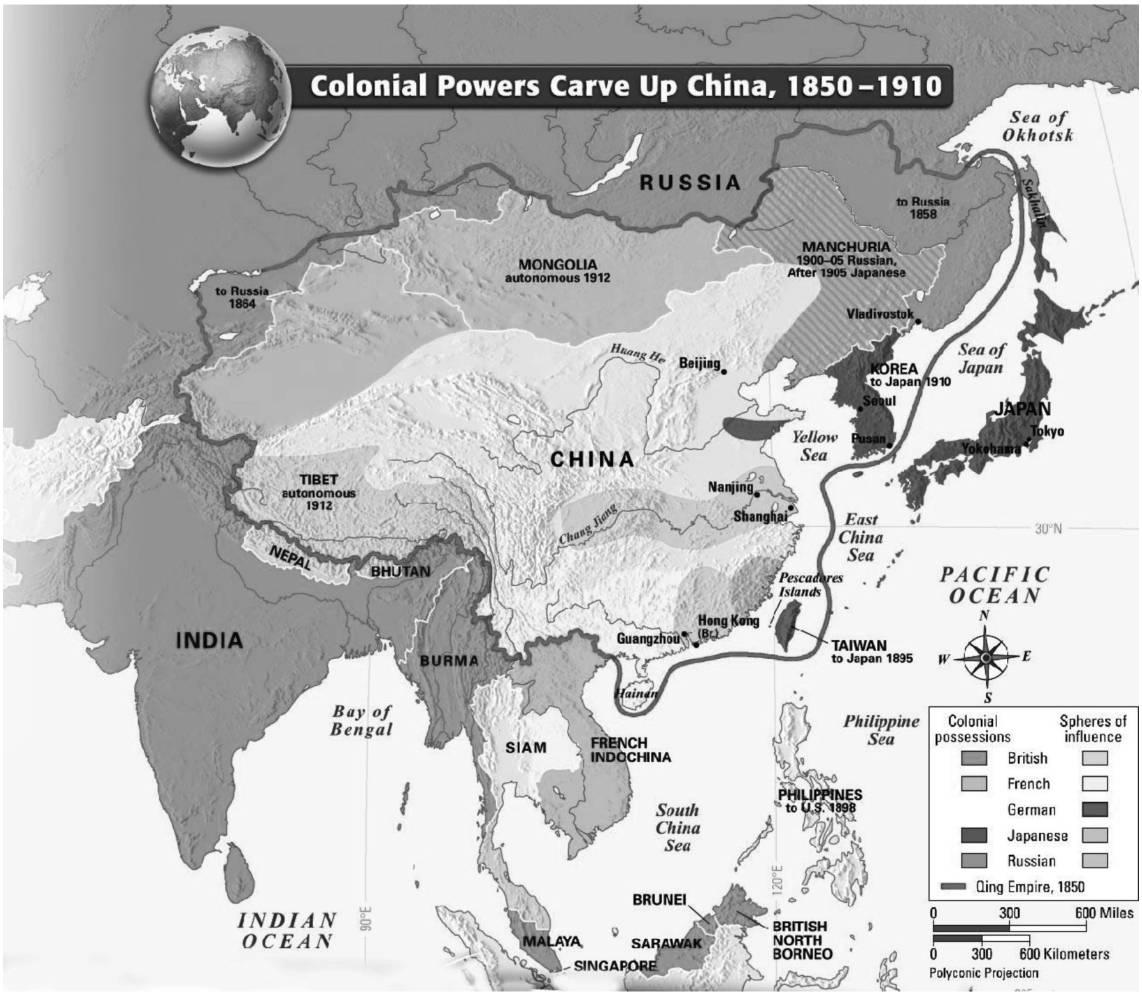
The Emergence of European Powers in East Asia – Geopolitical Context

Table 1 provides a rough yet adequate representation of how the East Asian political and socioeconomic map had been redrawn by the mid 19th century, the time when European nations and the United States started to emerge as determinant powers in the region. If we make a theoretic 'screenshot' of the constellation we see:

- China sitting less and less conveniently in the middle of its tributary system, reluctance in opening its trade to Britain leads to the first Opium War (1839-1842) and the first unequal treaty imposed by a European power on China;
- Korea being a stable and integral part of the Sino-centric tributary and Confucian governance system with strong trade links;
- Taiwan is being gradually integrated politically, culturally and economically into imperial China's Fujian province;
- Japan already showing strong signs of separation, distinction from the Sino-centric political and economic system as it closed its gates during the Edo period (1603-1867), yet its dominant philosophy, way of thinking remains Sino-rooted.

This screenshot shows relative stability and little motion. However, the appearance of the industrialized and aggressive Western powers completely tumbled the thousand years old China-centred system in a span of 70 years. The first Opium War (1839-1842) marked the beginning of what is known for China as the "Century of Humiliation". In the first two thirds of this period mostly European nations dominated China's foreign trade through numerous unequal treaties and concessions, as it is well reflected in Figure 1, that displays the spheres of influence in China in 1910. The robust changes had positive, but rather late impact on Taiwan's integration into China. Although the massive Mainland part of imperial China fell short of reacting well on the apparent shift of power in its environment, its trade ties with the newly agriculturalized West of the island of Taiwan were burgeoning (Chang, 2011, p. 82). Moreover, thanks to the beneficial developmental policies of the Qing government, Taiwan became a province separate from Fujian in 1887, and it quickly emerged as the most developed province of China that manifested e.g. in the completion of the first Chinese-built rail line (Olds, 2008). The partial achievements in Taiwan however did not keep imperial China from weakening further–and eventually collapsing.

Figure 1. Spheres of influence in China in the late 19th century



Source: Yankey 2005 (Owasso High School)

As seen in Table 1, Korea was more closely tied to the Sino-centric world than Japan. Korea thus gradually fell with China, while Japan managed to distance itself from the sinking of the empire through completing the shift from China with the ideological turn from Neo-Confucianism, which had been triggered by Western powers, primarily the United States from the 1850s. Imperial Japan was the first among the East Asian entities to react quickly and adequately to the (global) switches in power by adopting Western ideas and technologies as a result of the Meiji restoration in 1867.

Japan soon joined European nations to claim its share of East Asia. With the annexation of Qing China's Taiwan (1895) and Korea (1910) Japan not only imposed its might on the fading Confucian heartlands, but also did it in a manner that caused severe wounds to both China and Korea (Economist, 2015; Múlt-kor, 2007).

Table 2. The Far East in the 1910s		
Qing-China		Eventual collapse of the empire in 1911 after a series of humiliations by Western powers and Japan
	Taiwan	Under Japanese rule, trade reoriented towards Japan (Chang 2011, 82-84)
Joseon-Korea		Falls simultaneously with the collapse of China, annexed by Japan in 1910
Meiji-Japan		In the heydays of modernization Japan develops increasingly expansionist attitudes (Múlt-kor 2007), while the European powers tear one another down back at home, Japan advances its might in China[3]
Source: own compilation		

Reshuffle in the Inter WW Period – Political Context

European powers dominated China from the first Opium War through World War I, nevertheless, they seldomly exerted power in a unified manner, save for the defeat of the Boxer Rebellion in 1900. Other than that, European powers' agenda remained competitive in East Asia or cooperative at best. There is not much surprise in that the division of China into spheres of influence (Figure 1) mirrors an intra-European global

[3] With the so called 21 demands handed onto the Republic of China in 1915, Japan strived to formalize its control over its economic interests and rights gained in Manchuria, Inner Mongolia, as well as the German concessions in Shandong. Popular anti-Japanese sentiment rose in China in response. (Minohara–Hon–Dawley 2014, 78)

rivalry that had finally culminated in World War I, fought predominantly in Europe. There is, however, one reason why it is still important to briefly draw attention here to the pattern of European behavior in imperial China–having there a reflection of internally competitive agendas instead of an aligned, or at least cooperative strategy–that is, that it failed, and that the dominant nations of the EU follow a highly similar pattern in the early 21st century in East Asia, and China, as well. The U.S. on the other hand started to show early signs of its modern imperial thinking as it adopted and made every other stakeholder accept the "Open Door" policy to prevent China being dominated by a sole hegemon[4] (Encyclopaedia Britannica, 2015).

With the European dominance eroding three major external forces gained more importance within the Chinese Mainland: Japan, the Soviet Union, and the United States. Consider first the increasingly assertive Japan that–in my view–adopted a three-stage colonization approach:

- Taiwan: it is important to note that while the Chinese Mainland was suffering an era of warlordism on the ruins of a two thousand years old imperial system, its formerly incorporated and sinicized colony, Taiwan was enjoying a period of relative stability under Japanese rule. Although anti-Japanese movements emerged on the island, those became scarce by the 1910s (Tsai, 2009, p. 108), and Japan exported much of its modernization agenda to the Island partly to make it sufficiently assist Japanese expansionism, and partly to turn it into a "showcase" colony of the time (Abramson, 2004). Taiwan suffered significantly less from the Japanese world war activities than Korea or Mainland China (Abramson, 2004), which left the Taiwanese with less hatred and more sympathy towards Japan.
- Korea: Japan's role in Korea's history is more contradictory. Myung Soo Cha of Yeungnam University for instance writes that "… South Korea grew on the shoulders of the colonial achievement [under Japanese rule], rather than emerging out of the ashes left by the Korean War, as is sometimes asserted" (Myung, 2010). Although

[4] Even though it was mainly driven by the fear of remaining left out of the "Chinese cake".

Japan undoubtedly set the bases of modern Korean infrastructure, education, industry etc., it certainly did so in accordance with the needs of the Japanese empire's growth, and with the eventual aim to integrate Korea (and Taiwan) into Japan. Wartime atrocities and abuses such the case of comfort women[5] still cause serious frictions between the two Koreas and Japan.

- China: with the conquest of essential territories of the densely populated parts of the Chinese Mainland Japan became the first power in history to take over China along with its capital and still wield the empire from a centre outside of China–i.e. Tokyo. China suffered from the worst of Japanese militarism since 1937 being economically exploited and–again–humiliated. The most notable wound on the Chinese memory is the so called Nanjing massacre[6] (Mitter, 2014).

The gap between Mainland China and Taiwan widened during the period as there were few connections across the sides of the Strait, although the Republic of China maintained a diplomatic mission in Taipei at the time (Lan, 2002, pp. 6-8.). The contrast shown in the three stages of Japanese occupation of East Asia is perceived to explain much of the intertwining political attitudes of the four entities–China, Japan, (South) Korea, and Taiwan–today. The last important contextual pillar to understand Cross-Strait relations in the aforementioned multilateral context is the foundation of the Republic of China, the Chinese civil war and the role of the remaining international players.

As roughly introduced above, Japan was pushing ahead after the collapse of imperial China, but there were two other powers[7] to fill in the enormous political vacuum left behind the Qing dynasty and the self-destructing

[5] Korean women were forced to serve Japanese brothels in the largest numbers among the countries occupied by imperial Japan.
[6] The Chinese death toll is put to 300,000 by China, many Japanese historians estimate the figure to be significantly lower. (The Japan Times 2015)
[7] As well as Germany that completely reset its relationship with China and engaged with it in a mutually beneficial trade relation up until the start of the Japanese invasion in 1937. Germany did not have though political ambitions on the Chinese Mainland. (Kirby 1984)

European nations,[8] namely the Soviet Union and the United States. A good representation of the era is Sun Yat-sen's personal case, who is widely respected as the father of modern China,[9] he, however, never got to unify the country and set it on the path to development he desired his entire life. Systemic warlordism kept him from achieving lasting results, but his party found its way to strengthen to a potent power base with the help of Soviet advisors amidst the political chaos and ideological abundance. One can imagine the excitement of the period, with ideas ranging from those of the American pragmatism John Dewey to those of Soviet Marxist-Leninists informing the debates about China's future. It was in the quest fueled by intense nationalism, that the Chinese Communist Party (CCP) was formed. (1921, Shanghai); Comintern advisors ordered a handful of CCP members to join Kuomintang (KMT) individually… The Comintern position thus established one of the most curious facets of the long and bitter competition between the Communist and Nationalist parties: both were structured in the early 1920s according to the dictates of Leninist organization to create a centralized Chinese government allied to Moscow (Charlton, 2015).

The KMT and the CCP emerged in the 1920s as the two major domestic political powers to jointly unify the country by the 1930s with Soviet assistance, however, mounting frictions made the sides eventually split. Despite an interim cease-fire to resist Japanese invasion the two parties remained at odds, and large-scale civil war erupted after the defeat of Japan in 1945. By 1949 the Mao Zedong-led CCP backed by the Soviet Union (Heinzig, 2003, pp. 97-123.) forced the Chiang Kai-shek-led governing party (KMT) aided by the U.S. (Sandler, 1995, p. 75)[10] to flee to Taiwan that had been regained from Japan in 1945. Both Chiang and Mao largely abandoned Sun Yat-sen's idea of Chinese democracy within his Three Principles of the People (Kishlansky, 1995, pp. 281-284.), and both of them

[8] Europeans held their concessions in China after the world war (Kayaoğlu 2014, 155), but the prospects for them changed radically.
[9] Both in communist China and Taiwan. Professor Pál Majoros of Budapest Business School drew my attention to the fact and extraordinary significance that when KMT chairman Lien Chan visited China in 2005, he made a visit to Sun Yat-sen's burial monument in Nanjing.
[10] It is a simplification, the issue of which international power backs which Chinese side was more complex through 1945. (Heinzig 2003, 21-97)

set up an authoritarian regime of the two sides of the Taiwan Strait respectively (Copper, 2013, p. 108; Ervine, 2011).

<table>
<tr><td colspan="3">Table 3. The Far East in the 1950s</td></tr>
<tr><td rowspan="2">China</td><td></td><td>The end of Japanese aggression[11] signaled the start of a deadly civil war that the Communists came to win solidifying their control over the entire Chinese Mainland with the help of the Soviet Union</td></tr>
<tr><td>Taiwan</td><td>Comparatively less war-torn Taiwan experienced a switch in power as KMT took over after half a century of Japanese governance</td></tr>
<tr><td colspan="2">Korea</td><td>Liberated from Japanese rule the Korean peninsula got divided, and turned into spheres of influence of non-Asian origin: that of the Soviet Union's and the one of the Unites States'[12]</td></tr>
<tr><td colspan="2">Japan</td><td>After its unconditional surrender Japan lost all its overseas territories and it itself got occupied by the Allies, its new Constitution was drafted by the offices staff of Douglas MacArthur, the Supreme Commander for the Allied Powers (pbs.org)</td></tr>
<tr><td colspan="3">Source: own compilation</td></tr>
</table>

[11] A term often used in China to refer to Japanese occupation.
[12] Something did not happen before.

The Cold War Era

The chapter continues to draw up the multilateral framework of the Cross-Strait relations in the Cold War era. It is divided into three parts that break down according to the following: (1) the European and Asian Alliances, (2) the PRC-TW-US Triangle, (3) and the notion of developmental state that marks, and stretches through the period. The first two parts of the chapter deal with the core relationship from a broader, and then closer geopolitical perspective respectively. In the third part of the chapter the concept of developmental state, as a core East Asian "produce" of the era's hotbed is also analysed as well as its economic and political relevance.

EUROPEAN AND ASIAN ALLIANCES

The Cold War era is extraordinarily crucial for two vital reasons. One is that this is the period during which the "Taiwan issue" emerges as a question in international politics. The other is that it is also the time when non-(area-)possession-based foreign politics become dominant in international relations.[13] These two reasons together lift Taiwan and the Cross-Strait relationship up to a level of unique historical significance.

Before the war, the traditionally imperial China-centred East Asian economic and cultural power constellation was shaken up by the European colonizing powers, only to be destroyed by the rise of the Japanese empire as the largest regional player. By the end of WWII, however, only the United States and the Soviet Union managed to sustain (and increase) their influence in China,[14] and hence contribute to the dynamics of the Cross-Strait relations. With the entire East Asian region

[13] As opposed to the colonization era when predominantly Western European powers seized vast territories globally, and competed with each other to rule and exploit them. This classic era of global politics was fundamentally shaken by World War I, and had practically ended with World War II. The Cold War era brought a modern practice of global politics where power is exercised in ways and with means other than direct territorial colonization, particularly in the case of the United States.

[14] Both the Soviet Union and the United States acted largely in line with their respective political interests, rather than merely economic ones – as European powers did previously – with the former aiding the CCP in the re-erupting civil war, while the latter assisted the KMT (Copper 2013, pp. 199-200) that retreated to Taiwan after its defeat by the Communists.

in ruins after WWII and the Chinese Civil War (1927-1950), these two powers had gained a dominant role over the region by the end of the Korean War (1950-1953).
In the early stages of the Cold War, the two giants divided Europe and East Asia—the two major battle theatres of WWII—into spheres of influence. The American strategy of the era can be described as one of containment of the Communists' global expansion. Its official policy was the Truman Doctrine, a decisive element of which was to promote the economic growth of the nations within its sphere of influence in the two aforementioned regions—see the Marshall plan as well as the American backing of the rise of the East Asian developmental states. This took place while Washington contained them politically,[15] so that they would be able to form strong bastions at the two ends of the Eastern bloc. This was a dual, modern imperial approach that largely helped the United States win the Cold War, but left both Europe and East Asia fragmented.

In East Asia in particular, many of the wounds[16] inflicted during the first half of the twentieth century remained open as a result of this bipolar division. One key friction conserved within the new constellation was the Sino-Japanese relationship, as China became a key ally of the Stalinist Soviet Union in the early 1950s, while Japan was controlled primarily by American forces. The division of the Korean peninsula opened new wounds within the region on the one hand, while on the other hand it also left little room for Korean-Japanese reconciliation.[17] Perhaps the most

[15] The Japanese "peace constitution" was drafted under general McArthur (Encyclopaedia Britannica 2016a), and the Western European integration process also started and evolved under the aegis of Washington (Carolan 2008) with all major participants benefiting from the Marshall Plan (George C. Marshall Foundation 1952) and *de facto* acceptance of a leading US role in global issues.
[16] "Historic wounds" throughout the paper refer to the so-called transgenerational, historical, and collective trauma that East Asian nations went through during the periods discussed. Transgenerational trauma was first described by Byron Egeland, Inge Bretherton, and Daniel Schechter.
[17] In the case of North Korea, the reason is similar to that of the omission of the Sino-Japanese reconciliation, whereas the fact that South Korea became just as much an integral part of the American organized system of allies as Japan did, automatically gave priority for American foreign political objectives over Korean and Japanese ones. Such an environment did not help to reach a thorough reconciliation nor major political frictions that eventually could have resulted in reconciliation.

complicated and tense situation evolved in the Taiwan Strait. Political friction and military conflicts on the Chinese mainland between the Chinese Communist Party (CCP) and the Kuomintang (KMT), each backed by one of the powerful foreign superpowers, largely remained a domestic Chinese issue until 1949, after which this fight was exported to Taiwan during the closing stages of the Chinese Civil War. The situation was indirectly conserved by the breakout of the Korean War, which prompted the United States, alarmed by Communist expansion in the region, to dispatch its 7th fleet to protect Taiwan from an unfolding Chinese attack in 1951 (Copper, 2013, p. 47). This was the historic inflection point when the island emerged as a locus of global concern. With the retreat of the KMT to Taiwan, the island may have indirectly been saved (with American help) from an imminent Communist takeover, but the event also imported two major sources of conflict and friction: one with China, in the continuation of Chinese Civil War, and the other with Japan, under whose rule the KMT-led China had suffered badly for years.

THE PRC-TW-US TRIANGLE

The early stage of the Cold War conserved much of the historic wounds in the Far East in a bipolar political framework. This materialized in a web of mutual security agreements between the United States and its allies[18] which cemented American security engagement in East Asia:

- Security Treaty Between the United States and Japan concluded in 1951 (Ministry of Foreign Affairs of Japan, 2016)
- Mutual Defense Treaty Between the United States and the Republic of Korea concluded in 1953 (Embassy of the United States to Seoul, 2016)
- Mutual Defense Treaty Between the United States and the Republic of China (ROC) concluded in 1954 (Taiwan Documents Project, 2016a)

[18] As well as the Sino-Soviet Treaty of Friendship, Alliance and Mutual Assistance concluded in 1950 (Ministry of Foreign Affairs of the People's Republic of China), and the Soviet-North Korean treaty of friendship, cooperation, and mutual assistance signed in 1961. (Lukin, 2013)

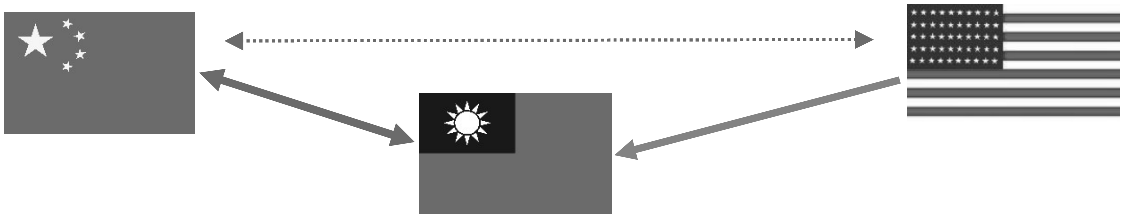
With these treaties we see that the three East Asian entities — all formerly under Japanese imperial rule — became closely, but separately, tied to the United States, and as such they became the bastions of a larger American strategy of containing communism, with Japan being the largest and the closest-bound to Washington. (The economic aspects of the US engagement are discussed in the final section of this part of the chapter.)

With the KMT's withdrawal from the Chinese mainland in 1949, the Chinese Civil War remained unresolved. Both the CCP in Beijing and the KMT in Taipei claimed the entirety of China,[19] and both Mao Zedong and Chiang Kai-shek (Kastner, 2009, p. 31) remained bellicose about these claims well into the 1970s. Chiang never gave up his resolve to recover the mainland (Copper, 2013, p. 50), while Mao launched several bombardments throughout the 1950s against Taiwan's offshore islands of Quemoy and Matsu (Copper, 2013, p. 48). In the United Nations, the ROC held the seat for China, but that did not result in Beijing's diplomatic isolation, as the countries of the Eastern Bloc and many other non-aligned nations recognized the People's Republic as the sole legal representative body of China.

Sovereignty is the very core issue that has been influencing Cross-Strait relations since 1949. Beijing has been consistently and firmly sticking to its determination to effect a unification of Taiwan with China. The sole reason it has not yet attempted this militarily is that the issue of Taiwan sovereignty gained global importance in the 1950s, when the United States engaged in protecting it from a possible Communist takeover. The first display of that engagement was the demonstration of power by the 7th fleet of the US Navy in 1950. Truman dispatched the fleet after the breakout of the Korean War in order to deter Mao from trying to capture Taiwan (Copper, 2013, pp. 199-200.). Then, in 1954, the mutual defence treaty was concluded between Washington and Taipei. From this very point we cannot really talk about Cross-Strait relations without taking the United States into consideration. An incomplete triangle had been shaped.

[19] The KMT claimed Outer Mongolia as well. (Lewis, 2010)

Figure 2



Source: Author

However, as the “Taiwan issue” became part of a broader American containment strategy, it has likewise been subject to the evolution of the Cold War. An intensifying arms race between the North Atlantic Treaty Organization (NATO) and the Soviet Union, and deteriorating Soviet-Chinese relations, made it possible by the 1960s for the United States to reconsider its relationship with Beijing. Taipei felt the winds of this threat and did whatever it could in the area of soft diplomacy to retard a Sino-US rapprochement (Copper, 2013, p. 199). It could not stop the inevitable, though: By the 1970s, two elementary changes had reshaped the triangle.[20] One was an actual rapprochement, as President Nixon visited Beijing along with Henry Kissinger and the Shanghai Communiqué was issued, stating that: “The United States acknowledges that all Chinese on either side of the Taiwan Strait maintain there is but one China and that Taiwan is a part of China. The United States Government does not challenge that position. It reaffirms its interest in a peaceful settlement of the Taiwan question by the Chinese themselves” (Taiwan Documents Project, 2006b). As a result, the PRC in 1972 was given the China seat in the United Nations, as well as on the UN Security Council. American—and further, Western[21]—diplomatic recognitions of Beijing followed over the course of the decade. The second major change had been brought in by Deng Xiaoping’s opening-up policy late in the 1970s that brought in a potential economic factor into Cross-Strait relations.

[20] Similar triangles could be drawn up during the Cold War era with the United States’ other East Asian allies in the vertex of Taiwan: initially Japan–as well as South Korea–felt threatened and abandoned by the American-Chinese rapprochement. (Teo–Guen, 2014, p. 47)
[21] Its European allies and Japan follow the United States.

The Sino-American side of the Beijing-Taipei-Washington triangle became complete in the 1970s. It was a shift within the triangle that caused the ROC immense losses in international recognition, but the US Congress compensated somewhat by passing the Taiwan Relations Act (TRA) that "re-established Taiwan's status as a sovereign nation-state in allowing Taipei to continue to post representatives in the United States, access to US courts and retain diplomatic privileges. Finally, it provided Taiwan with security and economic guarantees"[22] (Copper, 2013, pp. 200-201). With the diplomatic recognition of the PRC and the passing of the TRA, the United States practically institutionalized its strategic ambiguity regarding its Cross-Strait policies. "After that, the United States had, many said, two China policies: one made by the White House ... (pro-Beijing), the other made by Congress (pro-Taiwan). There were subsequently two forces at work..." (Copper, 2013, pp. 23). These forces often sent conflicting signals from the US side of the triangle that could lead to loss of confidence among its East Asian allies, and at the same time, could potentially trigger Cross-Strait and Sino-Japanese political rapprochement.

These triangles in the Far East were mostly shaped by the edge connecting two vertices with the two behemoths (the United States and the PRC), while the sides at the third vertex—Taiwan, Japan, and South Korea—followed, this was true for Taiwan in particular.[23] At a roundtable discussion held at the Central European University in January 2016, Ivana Karaskova of Charles University in Prague went so far as to claim that it didn't really matter who won the elections in Taiwan, it is the relevant laws and their respective behavior of the United States and the PRC that will determine the island's future.

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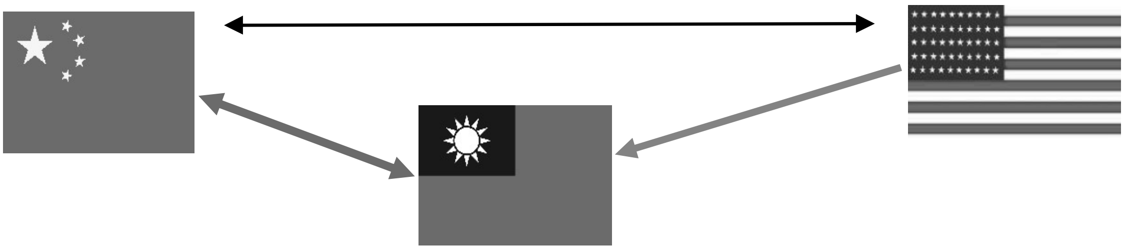
[22] The United States will "consider any effort to determine the future of Taiwan by other than peaceful means, including by boycotts or embargoes, a threat to the peace and security of the Western Pacific area and of grave concern to the United States." Note that none of Washington's global allies passed any acts or laws similar to the TRA, leaving Taiwan literally alone in the international security arena.

[23] It was not until the 2010s that the movements between China and the East Asian US allies started to significantly impact the triangles –that in the meantime turned to polygons with multiple corners.

Figure 3



Source: Author

These drastic changes to the triangle in the 1970s moved Cross-Strait relations away from their stalemate. The major milestones of the Cross-Strait rapprochement until the end of the Cold War are:

- In 1979, "A Message to Compatriots in Taiwan," a statement by the Standing Committee of the Chinese National People's Congress showing Beijing's peaceful attitude towards dialogues with Taipei. It was announced on the same day that the Joint Communiqué on the Establishment of Diplomatic Relations between the United States of America and the PRC was issued (American Institute in Taiwan, 2016);
- In 1981, Marshall Ye Jianying issued his "Nine Points" plan for a peaceful unification by providing Taiwan with a high degree of autonomy (Kastner, 2009, p. 32);
- In 1987, martial law was lifted in Taiwan, and citizens were allowed to travel to the mainland to visit relatives (Kastner, 2009, p. 32.);
- In 1991, the Straits Exchange Foundation (SEF) and the Association for Relations Across the Taiwan Straits (ARATS) were founded in Taiwan and China, respectively, as semi-official intermediaries to deal with Cross-Strait relations (Goldstein, 2015); and
- In 1992, what is today called the "1992 Consensus" was first employed by SEF and ARATS negotiators. The consensus is often enunciated by its proponents in Taipei as "there is one China, with each side having its own interpretation of what that means" (Taipei Economic and Cultural Office in Canada, 2016).

The gradual establishment of political ties was in line with the evolution of Sino-American relations. This period also marked the first large step toward ending the continued lingering of the previously mentioned historical problems and frictions in East Asia. As the Cold War thawed out in the 1990s, the wounds of the past also defrosted—as we will see—in both Cross-Strait relations and the larger East Asian region. The final pillar for the overall understanding of the background of current Cross-Strait relations in a multilateral framework is set up by the following part, which introduces the post-world war rapid economic development of the United States' East Asian allies.

Developmental States

As already stated, the United States' strategy since the early stage of the Cold War era had been to contain Communism, and a key pillar of the strategy had been to (help) building strong bastions at the two ends of the massive Eastern Bloc so as to counter the expansion of Communist ideology and might. Economic implications were as important elements of this strategy as its security ones, thus the U.S. implemented a broader two-track aiding and assisting policy, that helped revive the ruined economies of allied Western Europe, and East Asia. The fundaments of industrialization as well as technological know-how were present in both regions, several centuries old in the former, while short of a century old in the latter. Western Europe greatly benefited from the Marshall program, and was able to revive its internal economic circulation as it started to adopt an integration agenda, but East Asia required a different approach. I see the main reasons being:

- A lack of democratic traditions in East Asia (Japan, Korea, Taiwan);
- Lower technological base–with the partial exception of Japan;
- Unaddressed issues from the world war left the nations with severe historic wounds mostly linked to (imperial) Japan, therefore a Japanese leading role in a regional post-war economic reconstruction, i.e. integration would have been unimaginable;

- The largest East Asian entity, Mainland China turned Communist, that automatically ruled out any ideas of a modern restoration of the old imperial China-centred East Asian economic room.

The path, that Japan, South Korea, and Taiwan followed was later described as the concept of "developmental state" (Chalmers, 1982). Their miraculous economic rise has been widely studied and admired worldwide, and the stages of the rise are also well-known. The current paper does not intend to add to or conclude from the extended literature any new ideas on the concept itself, it simply tries to represent the direct and indirect importance of it within the Cross-Strait relations as well as the broader East Asian region. Based on the three tables – and snapshots – of Chapter 1 here three simple facts are to be underlined:

1. Before the incursion of aggressive European powers into East Asia, the region was dominated by the ideological and economic might of the Chinese empire, with Japan increasingly distancing itself from this Sino-centric system, while remaining strongly Confucian;
2. Western powers continued their colonization agenda in East Asia, but also scattered the seeds of the need for constant technological advancement;[24]
3. There was only one nation in East Asia – Japan – that was willing to realize its weaknesses compared to Western powers and also able to make almost immediate and radical shifts in its political and economic system to address it.

What the Meiji restoration created is regarded as the forerunner for the modern concept of "developmental state". Confucianism – even though its social order is largely disrupted – is broadly recognized by scholars as one of the key factors for success of the developmental state in East Asia. Japan's model was a highly successful, systematic reconciliation of Confucian and Western values, and as long as it stuck to its traditional values the concept worked.[25] The developmental state is essentially a

[24] "Development carries with it the assumption of linear, and progressive change. It is linear … in its assumption that history means progress. Progress in turn means material advancement in the broader sense." (Charlton 2014)

[25] From the late 19th century, imperial Japan gradually – see the three stages of Japanese rule in Chapter 1 –

Japanese invention rooting in the soil of Confucianism of Chinese origin and inseminated by Western modernization. Below are listed the major commonalities of the Post-WWII East Asian entities – i.e. Japan, Taiwan, South Korea – before their economic take-off, and then their developmental characteristics are briefly introduced (Charlton, 2014).

- American alliance: as the Far Eastern cornerstones of Washington's global strategies, all three nations enjoyed the protective security shield of the United States as well as its supportive economic programs, and aids;
- Confucian traditions: high respect of labor, and extraordinarily high work ethic provided the social fundaments of an economic kick-off;
- Japanese economic fundaments: as discussed before, all the three, though largely destroyed, had industrial, infrastructural as well as educational fundaments inherited from imperial Japan;
- One-party rule: competent central control was key in the facilitation of the economic boom in Japan, Taiwan, and South Korea.

JAPAN

The overall success of the Meiji reform is generally attributed to its push for modernization combined with the formation of the *zaibatsu*s (Charlton, 2014), that were gigantic – mostly – family-controlled, vertically organized enterprises with activities covering basically all fields of the economic spectrum from textile manufacturing through chemical, and heavy industry to trade, and finance (Enyclopaedia Britannica). After Japan was defeated in the World War, the occupying United States had a strong interest in recovering the Japanese economy – and sufficiently supported it (Bai, 1997) –, which met with the resolute intentions of the formulating new political powers. Sue and Silbermann (Charlton, 2014) describes the historic transformation brought along by this lucky coincidence of

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abandoned one of the core values of Confucianism, that is the promotion of peace and harmony (Yao 2000), which shortly turned out to be destructive, and had a catastrophic end. Berkeley Center for Religion, Peace and World Affairs: Confucianism on Peace and Violence.

interests as: "*At the core of this [rational] state is a bureaucracy designed to reduce uncertainty, and improve coordination to achieve the politically determined goals of development.*" A descriptive ideal of such a formation is the belief that "*the public interest is too important to be left to the public*" (Ibid). The economic reconstruction of this nature, however, probably could not have been achieved in a liberal democratic system that the American-led allies required from the historically Confucian Japan, unless there had been a party that was able to manifest itself as the sole capable guarantor of such a transformation. The Liberal Democratic Party (LDP) did that, and ignited a massive economic boom that shifted the country to the second largest economy in the world and solidified the party's leading position through the Cold War era.[26] The so called Iron Triangle stands for the uniquely successful cooperation and coordination between the LDP, high-ranking administrative personnel, and top keiretsu[27] chiefs (Chalmers, 1982, Charlton 2014).

TAIWAN

The Taiwanese economic miracle had lifted the island to a major global economic player by the end of the Cold War. A brief overview is hereby provided of the three essential factors that the Taiwanese boom was based on.

Japanese heritage

As mentioned earlier, despite the fact that Taiwan's economy was subordinated to Japanese expansionist demands, the island was the least negatively affected by Japanese colonialism in general. Although considerably damaged, the Japanese left behind (Dreyer, 1987):

- a decent network of infrastructure including roads, railways, electricity, and ports;
- factories, as the fundaments of industrial activity;
- sanitation, and education system with high ratios of enrollment;

[26] The LDP remained the dominant political power after 1991, too.
[27] The transformation of the rather centralized *zaibatsus* to the rather horizontal, but closely coordinated keiretsu-model was instrumental in the „Japanese miracle".

"[In 2006 Japanese] foreign minister Taro Aso ... declared ... that Taiwan owes its advanced educational level to compulsory educational policies imposed on the island during the 1895-1945 Japanese colonization" (Jeffries, 2006, p. 74).

Foreign support and investments

The United States and Japan played a key role in the early stage development of the post-war Taiwanese economy by providing crucial aid and loans. „*In the early years, US economic aid and advice was as important to Taiwan's industrial progress as they were to its agricultural growth. From 1950 to 1964, the United States injected nearly $100 million annually into Taiwan's economy, money critically needed to build Taiwan's new factories. As a matter of records, from the early 1950s to 1960, US aid provided 40 percent of Taiwan's capital formation, most of it helping the industrial sector. Few underdeveloped nations at that time or since have benefited as much from economic growth generated by foreign aid*" (Copper, 2013, p157). American and Japanese companies took the leading role in investing into Taiwan's preferential economic zones, that helped the island's economy upgrade, mature, and integrate more deeply in global supply chains (Kau-Simon, 1992).

World-class economic planning

None of the above mentioned factors would have been proven to be sufficient in reaching such high-speed economic advancement, hadn't the Taiwanese government performed excellently in economic coordination, and forecasting. Central planning orchestrated the economic reconstruction, and development of Taiwan in a way that it provided enough protection for businesses to establish, effective incentives to grow competitive internationally, and timely communication that signaled major shifts in policies to help adapt or transform (Copper, 2013, pp. 157-166.). Confucian values were given large room to manifest as family-owned enterprises proliferated in a rapid pace, while the many factories that had been built as a result of beneficial policies absorbed the majority of the then cheap labor force – with strong work ethic.

SOUTH KOREA

Japanese and American role

As it had been in the case of Taiwan, the Korean economic miracle also has roots in the Japanese colonialism. Cumings argues, that – although even more predatory in nature than in Taiwan – the Japanese planted the seeds of developmentalism on the Korean peninsula. (List-Jensen, 2008) Kohli explains the emergence of the Korean tally of the Japanese *zaibatsu*s in the 1960s,[28] the chaebols, whereas the rise of the working class – a major pillar for a rapid economic take-off – can also be attributed to the Japanese presence: there were less than ten thousand industrial workers in 1910, but that number reached 1.3 million in 1943 (List-Jensen, 2008).

Although Minns points out, that American aid was not as instrumental in the South Korean industrialization process as it had been in the case of Taiwan (Minns, 2001), Kim and Lim notes (Kim-Lim 2007, p. 71), that the United States provided over 13 billion USD in economic aid, and military assistance for the Republic of Korea. Even though American aid sharply declined in the 1960s (Minns, 2001), "*It is inconceivable that South Korea could have succeeded in the absence of America's willingness to throw open its markets to the export of Korean manufacturing products, and in the lack of the U.S. security umbrella*" (List-Jensen, 2008; Solomon, 2005).

Similarities and differences

The chaebols were rather reminiscent of the Japanese zaibatsus – and later keiretsus – as they were hierarchically structured, gigantic, and mostly family-centred conglomerates (Lee-Han, 2006, p. 309). The South Korean state not only directed the industrial shifts in the economy, but it also became an entrepreneur itself by investing in the different sectors – the chaebols –, thus establishing close political-business ties (Amsden, 1989; List-Jensen, 2008). In Taiwan the state also supported its industries in the different stages of the economic take-off, yet it remained a strong

[28] Since the colonial state preferred to work with large business groups.

coordinator, and facilitator, rather than an active participant in business.[29] Taiwan gradually decreased state ownership in its large enterprises, and welcomed foreign investments from the early stages, (Copper, 2013) while also encouraging its domestic companies to engage in international integration (Crookes-Knoerich, 2015), whereas Korea, and Japan (Copper, 2013) followed a more protective strategy. Its stock of foreign direct investments stood at a mere 78 million USD in 1967 (Evans, 1987), while it manipulated foreign exchange rates, and actively guided its banks' lending activities to foster its export-oriented sectors[30] (List-Jensen, 2008).

CHINA

In the 1990s, the end of the Cold War era, the world economy could be best described by the trade, and investment flows among the three most developed regions of the globe: North America, Western Europe, and East Asia. During the Cold War, the global economy had been reorganized with the leading role of the United States, which "brought up" the other two developed regions, and back to global economic circulation. However, there had been major differences between the Far East, and its Western counterparts, with the most important being the degree of regional economic integration. Even though Japan rose as a major investor in the Taiwanese economy, and Taiwan developed a high-class electronic parts supply sector that was highly complementary with the Japanese economy, the economic growth of the big three (Japan, South Korea, Taiwan) had predominantly depended on the Western markets throughout the period.[31] As all three entities applied an export-oriented developmental strategy –, and because of the historic legacy of Japanese imperialism was conserved in the Cold War, the Far East was lacking a true economic integrational force. Being the historically core integrational force in the region, China, however, started to show up in the 1980s. The United States' role was again momentous in the 1970s:

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[29] This is also mirrored in the fact that in the early 1990s the Taiwanese enterprises did not have significant influence in the forming of Taiwanese politics. (Kastner 2009)
[30] The financial system serves as the eyes, and hands for the state's industrial brain. (List-Jensen 2008)
[31] As a mapping of the three Cold War triangles in politics introduced in the previous part.

- It headed the Western World, and its allies in recognizing Beijing as the sole legitimate representative of China;
- and by doing so, it also played a crucial role in later igniting the enormous Chinese economic growth.

With Deng Xiaoping, China stepped on the path of the developmental state in the late 1970s as well. It already had several models to study, and it did so thoroughly, e.g. Singapore's, the only one of the four Asian tigers (South Korea, Taiwan, Hong Kong, Singapore) plus Japan that still has a largely authoritarian regime in the 2010s, yet keeps constantly ranking in the top positions in different competitiveness reports[32] (World Economic Forum, IMD 2016). *"Xi Jinping himself has said that China's modernization process has been undeniably shaped by the »tens of thousands of Chinese officials« who went to Singapore to study Lee's model"* (Tiezzi, 2015b). In the closing Chapter China's immense transformation is examined, as well as how it is reshaping the regional landscape, the world economy, and the Cross-Strait relations.

A New Era

"Look back at the last several decades. All the countries that foster good relations with the US become rich." Not a scientifically proven fact; nevertheless, important ideas from 1979 for at least two reasons. One is that it suggests that, even though the Cold War cast its political shadow on the world, countries of strategic importance for the United States could still prosper economically. The second reason is that these words were said by Deng Xiaoping, then paramount leader of the PRC, who spoke them while on a plane headed towards the United States to answer Li Shenzhi's — then president of the Chinese Academy of Social Sciences — question: "Why do we attach such great importance to our relationship with the United States?" (Yang, 2014).

The third chapter breaks down into six parts, and aims to reveal the major trends, developments, and forces currently shaping the future of Cross-

[32] China also sent several scholars to the People's Republic of Hungary in the 1980s to study the experiences of the so called New Economic Mechanism, a uniquely market-oriented model within the Eastern Bloc that was introduced from the late 1960s. (Salát 2009)

Strait relations, while also drawing three assumptions that point out potential directions for further research.

REARRANGING RELATIONS

In the 1970s, in the middle of the Cold War, China's diplomatic recognition by the United States[33] and most American allies—along with China's later market-oriented opening up policies—created a foundation for a new era. American entrepreneurial participants benefiting from the Chinese economic reforms were important, but not to the extent that they had been for Taiwan's boom. It was the newly emerged Asian economies (Japan, Taiwan, Hong Kong[34]), that took a leading role in investing in China in the 1980s (World Bank, 2010). Paradoxical as it is, it was the Cold War that ensured a secure environment for the Asian Tigers to rise economically by freezing most historical problems in East Asia. China's appearance as a developmental state was probably only feasible with the profoundly pragmatic and reformist approach taken by Deng.

The ongoing Cold War provided China, too, with security for its capitalist transition. Although at the end of the Cold War era, the Tiananmen square massacre had cast a pall over the CCP's international standing, Deng then decided to deepen the reforms and opening, starting a rapid economic rise that was unprecedented for such a huge country. With China's growing strength, its pragmatism gradually decreased into the 2000s, and we have been seeing it reshaping the entire East Asian and global economic landscape ever since. This landscape is still being shaped now, and although it is difficult to doubt its regional and global importance, the far-reaching consequences remain in doubt. Three assumptions on historical correlations can be made that require thorough and in-depth research:

1. The first assumption is that in East Asia's natural economic constellation China is a major, core integrative or gravitational force, and Japan is a secondary economic centre. Considering that

[33] This was the so-called China card that Nixon played against the Soviet Union (Copper, 2013, p. 200), thereby potentially laying the groundwork for the emergence of China as a new main competitor for the United States in global political and economic dominance.
[34] South Korea was more cautious; it was the last country in Asia to give Beijing diplomatic recognition in 1992. (Kim, 2012, p. 502)

this balance, which has lasted for thousands of years, has been disrupted by the appearance of a Western power—and Japan's rapid rise as a result—if all East Asian economies adopt the developmentalism that Japan successfully implemented, the balance will shift back to its original stand with proportional shares in global trade. With China being the last major actor to tread this path, we may see a devolution of economic relations in the region.

2. The second assumption is that the disruption of the economic and political balance in the Far East left the region with severe historical wounds that had been frozen in place during the Cold War era. As these wounds have not been treated, and remained unresolved, they turned out to be the major contributors to current East Asian frictions.
3. The third assumption follows from the first two: the economic integrative (gravitational) force and the historical (traumatic) divisive force are two countervailing forces that largely explain the map of economic and political evolution in East Asia.

THE REARRANGING EAST ASIA

The East Asian economic landscape has changed greatly. The momentum for high rates of economic growth declined in Japan, South Korea, and Taiwan in the late 1980s, 1990s, and 2000s, respectively, while democratic systems have been established in all three nations. Their economic growth is not dependent solely on Western markets anymore; their perspectives are rather determined by their economic ties with China, which has emerged as the major Asian country in which to invest, draining much of the global FDI that formerly flowed into the smaller Asian tigers. China has become the No. 1 trade partner as well as a top investment destination for Japan, South Korea, and Taiwan. There have been some remarkable patterns of how economic integration with China is perceived to be influenced by unresolved historical wounds.

Perhaps the most controversial of these patterns is in Cross-Strait relations. Kastner (Kastner, 2009) provides an excellent picture of how Cross-Strait economic relations evolved under the different presidencies in Taiwan starting from the 1980s, and how severing or easing political frictions influenced (or why they did not influence) economic exchange. Taiwan's case is the most controversial of all, because there is a widespread fear of deepening economic integration with China, best represented by Lee Teng-hui's "Go South" policy and other initiatives that tried to artificially divert—with little success—Taiwan capital from investing in China for fear of losing the technological edge to Chinese firms. Kastner points out that China was welcoming Taiwan businessmen, even during tense political times—e.g. the 1995-1996 Taiwan Strait Crisis and after passage of the 2005 anti-secession law[35]—assuring them that their business operations would remain unaffected, no matter what happened. Such soothing words from Beijing were largely absent when anti-Japanese protests swept through China after the Japanese central government announced that it had nationalized some of the Senkaku/Diaoyu Islands claimed by China. Japanese cars, restaurants, and factories were damaged by rioters during the course of the upheaval, and Japanese automakers struggled for more than a year in the aftermath of the protests to gain back their previous share of the Chinese car market—the largest in the world (Liang, 2015). Consecutive World Investment Reports showed that the emphasis of Japanese FDI shifted from China to the member countries of the Association of Southeast Asian Nations (ASEAN), which can be at least partly attributed to political tensions resulting from unresolved historical issues. It did so while South Korea's engagement has been growing. In 2014, Japan's investments in China decreased by 39 percent, while South Korea's rose by 30 percent (WIR, 2015, p. 41). South Korea was also the first to conclude a free trade agreement (FTA) with Beijing in 2015 (Tiezzi, 2015a), whereas unresolved historical issues hampered the development of both the planned Sino-Japanese-Korean trilateral FTA and the Cross-Strait Service Trade Agreement, with negotiations on the former halted until late 2015 (Teo, 2015), and the latter left unratified (Lo, 2015).

As for the depth of Taiwan's economic integration with China, the island's business community seems to be taking the lead. Smaller-sized suppliers followed large companies across the strait, predominantly to Guangdong, to establish entire supply chains (Kastner 2009, p. 62). Their success is

[35] Two major mementos of the unresolved sovereignty issue.

widely attributed to there being a common cultural and linguistic background. An excellent example of how Taiwanese companies were ready to integrate more deeply into the Chinese economic system is provided by the MLP TD-SCDMA program, where major multinational corporations (MNCs) from the West, afraid of technological spill-over, were reluctant to cooperate with the Chinese state and state-owned companies to upgrade that country's telecommunications system by developing the 3G mobile standard according to Chinese standards. Taiwan-based enterprises were ready to do that, and gained considerable market share as a result. "An interviewee from a Taiwanese enterprise revealed similar concerns, suggesting that Huawei was able to upgrade technology through reverse engineering from its cooperation with Taiwanese firms, just like Taiwanese enterprises used to do when MNCs were outsourcing to the East Asian latecomers back in the PC era" (Crookes-Knoerich, 2015, p. 86). "In short, the Taiwanese chipset suppliers helped mainland small scale private enterprises to enter the mobile phone market, which used to be dominated by capital-intensive and technology-intensive MNCs" (Crookes–Knoerich 2015, pp. 93).

Japanese MNCs, on the other hand, seem to be more cautious about deeper integration with China. A *China Daily* article published in 2012 claimed that from 55 percent to 60 percent of Sino-Japanese trade comes from Japanese inter-company trade (Jin, 2012), which suggest that production costs play the key role in Japanese investments. It might not have occurred just by chance that the first Chinese brands that became competitive in high-tech global markets came from the same sectors in which their Taiwan-based counterparts had established global brands before.

In a rather representative manner, the forces that work towards economic integration in East Asia appear to have a tendency to centralize in China, while countervailing forces also seem to follow a pattern marked by unresolved historical issues. With the end of the Cold War, old rivalries have also thawed out. The further deepening of economic integration in East Asia is inevitable, which makes facing these unresolved historical issues unavoidable. The most controversial of all is the Cross-Strait relationship, burdened by the legacy of Japanese colonial rule as well as the Chinese Civil War that was exported to the island in 1949, and which is now expressed in an intra-island division. The two ruptures are manifested in political and economic dimensions, as Kastner analyses, in a controversial and unique way.

What also seems to be inevitable is China's becoming increasingly competitive by upgrading its level of technological capacity. Indigenous innovation is something that is already present in China, and Taiwan-based companies—as mentioned above with the example of the SCDMA project—are not just victims of that, but became integral parts and beneficiaries of the process. Japan, South Korea, and Taiwan can all benefit from an innovative China, as it would drive them to keep their technological edge, and they would have close access to China's comparatively low-wage labor pool. This makes deeper East Asian economic integration desirable, and the resolution of historical issues necessary for all participants.

GREAT POWER STRATEGIES36

If we zoom out from East Asia, we see the rearrangements taking shape there in a broader global context. The fact that Japan, South Korea, and Taiwan are all now democracies is not only the result of a natural course of development, but also evidence of American political leverage. As a legacy of post-World War II establishments, the United States is still a huge stakeholder in East Asian economic and political developments. It facilitates strong trade links; its companies manage immense investment portfolios in the region; and last but not least, it maintains a powerful military presence, and still provides a security umbrella for its East Asian Cold War (and newer) allies, closely encircling China. The economic, financial, and security system that it has built since WWII, however, does not seem to be accommodating of China's rise. Moreover, multiple American movements have been interpreted by China as hostile, or of being part of a containment strategy. These include US military exercises in the East and South China seas and the Trans-Pacific Partnership (TPP) agenda pursued for a profoundly free Pacific economic space—a grouping that China would be excluded from. But China has been growing for

[36] Much of the theoretical background is based on my earlier book written on the Senkaku/Diaoyu issue and Sino-Japanese relations. (Szentesi, 2015)

decades at a pace with its East Asian forerunners, and with a population size larger than the United States and the entire European Union, Japan, South Korea, and Taiwan combined. That means that its sheer size alone is straining the frames of all the global economic and financial systems that have been created under and dominated by American leadership since the late 1940s. As Sándor Kusai, former ambassador of Hungary to China, suggested at a recent lecture at the Antall József Knowledge Centre on the China-initiated Asian Infrastructure Investment Bank (AIIB)[37], since China perceived the transformation of current global financial institutes as being too slow, it therefore started to create its own—i.e. the AIIB and the BRICS' New Development Bank. He pointed out the US Congress' five-year-long (until December 2015) agony to ratify the International Monetary Fund (IMF) reform package that, *inter alia*, granted more voting power to China and India.[38] Then he pointed out that the IMF's decision to include the renminbi (RMB) in the special drawing rights (SDR) currency basket was made mostly at the expense of European currencies, the Euro and the Pound Sterling, which speaks to the subordinate position of the European Union.

If we consider the European Union, it has been a rather passive actor within the American-Chinese rivalry in the global political arena. The United States initiated the TPP to head a profound economic integration of the Pacific just as the Transatlantic Trade and Investment Partnership (TTIP) was intended to lead a profound economic integration in the Atlantic. In response, China initiated the Regional Comprehensive Economic Partnership (RCEP) to cement its own economic integration in the Pacific and Indian Ocean regions, headlined by the One Belt, One Road (OBOR) trade initiative to link the East Asian and European economic spheres. If we take a look at the European Union, we see Germany, France,

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[37] The lecture itself was held by Ágnes Szunomár, head of the research group on Development Economics at the Centre for Economic and Regional Studies, Institute of World Economics, Hungarian Academy of Sciences. Find the event at: http://www.ajtk.hu/hu/calendar-events/2016-02-02?mini=2016-02

[38] He echoed the words of Gerald Curtis, Burgess Professor of Political Science at Columbia University: "If the US congress had agreed, as Obama has wanted to give China greater voting power in the IMF this (establishment of the AIIB) might never have happened." (Hong, 2015)

and the United Kingdom (Gani, 2015; Beaupuy-Viscusi, 2015; Li-Fu, 2011) sealing deals with Beijing worth billions of Euros, but there is no significant unified European economic initiative toward either the world's largest (the United States) or second-largest (the PRC) economies, despite the fact that each of these powers has competing trade-bloc initiatives, or that the EU's combined economic might tops both the American and the Chinese. Instead, the EU is on the verge of dismantling itself, unable to handle its internal and regional issues. This situation is highly reminiscent of the Qing dynasty (1644-1912), when the major European powers each had their own separate axe to grind with the Qing court. The difference is that now, China has largely emerged from the ruins left by its imperialist and Maoist periods. The Beijing-led AIIB triumphed over Washington's counter-lobbying in 2015, when major European nations like Germany, the United Kingdom, and France, as well as Australia and South Korea, signed up to become founding members (Eisenhammer, 2015). This could be a good start for a Europe seeking to de-leverage itself from American interests.

Taiwan is at the very centre of the United States' and China's mutually conflicting regional economic and security agendas, and at the TPP-RCEP intersection. As discussed in the previous section, Taiwan is also the place where historically divisive and economically integrative forces work in the most complex and controversial way in the Far East. These two conditions make the island a thermometer of the world.

TAIWAN STRAIT: THERMOMETER OF THE GLOBE

As Copper notes (Copper, 2013), after Hong Kong and Macau were given back to China by their respective European colonizers, a *de facto* independent Taiwan alone remained as a testament to what the Chinese call the "century of humiliation"[39]. The Taiwan issue is the single most sensitive political issue for Beijing outside of China. External and internal

[39] That started in 1842, when the Qing dynasty lost the Opium War against England, and ended with the defeat of Japan by the Allies in 1945. In this interpretation, even though Taiwan was returned to China, in fact it kept being separated from the mainland as a legacy of past humiliation. China would only completely recover if it unified with Taiwan. The paper's frequent use of the phrase "historic wounds" mostly relates to the (remnants of this) "century of humiliation."

countervailing forces shaping the Cross-Strait environment had been generally introduced until the end of the Cold War era, and the current global context has also been structured to provide a framework for interpreting the multi-faceted evolution of Cross-Strait ties since the 1990s. This closing section strives to underline the developments that are important to understanding Cross-Strait mechanisms, and which can be the basis for further research to test the three aforementioned assumptions.

Cross-Strait political relations showed signs of easing in the early 1990s, albeit at the semi-official level, with the parallel creation of SEF and ARATS. The year 1991 was a milestone for Cross-Strait rapprochement as the National Unification Council was established and the guidelines for National Unification were approved in Taipei, (Copper, 2013) and most importantly, ROC President Lee Teng-hui officially gave up the ROC's resolve to recover the mainland (Jeffries, 2006, p. 31). In 1993 an historic meeting between the heads of SEF and ARATS, known as the Koo-Wang talks, took place in neutral Singapore (The Straits Times, 2015).

The classic Cross-Strait triangle had been activated when political dialogue between the two sides took a negative turn, as Lee began to increasingly favor independence over unification. In 1992, the administration of US President George H.W. Bush approved the sale of 150 F-16 fighters to Taiwan[40] (Richardson, 1992). Taipei began applying for membership in international organizations including the United Nations, and the Koo-Wang dialogues were stalled until 1998. Lee's 1995 visit to his American alma mater Cornell University (Copper, 2013, p. 56) and the prospect of the first free elections in Taiwan further fanned the flames of Beijing's ire. In response, China conducted missile tests in the Taiwan Strait in 1995 and continued them into 1996 in an attempt to deter Taiwan's voters from voting for Lee (Ibid. p. 57). The triangle got into motion, and tensions escalated into what became the largest demonstration of American military might since the Vietnam War (Ibid.

[40] It was not just a gigantic weapons deal, but it was a deal that potentially secured Taipei's air superiority in the Taiwan Strait at a time when China's air force was largely outdated.

p. 202). Also, due in part to China's threatening military posture, Lee won a landslide victory in the presidential elections, making him the first directly elected ROC president in the history of the nation. Later, in 1999, he publically defined Cross-Strait relations in an interview as being of a "special state-to-state" nature. This characterization infuriated Beijing, which resolutely insisted that Taiwan was merely a "renegade province" awaiting unification. Kastner writes: "Mainland leaders staunchly opposed Lee's efforts to redefine Cross-Strait relations … where both sides possess equal sovereignty" (Kastner, 2009, pp. 34-35).

In 2000, Chen Shui-bian of the independence-leaning Democratic Progressive Party (DPP) was elected president, and while he set a surprisingly cordial tone toward China in his inauguration speech, his refusal to accept the "1992 Consensus" as the baseline for further Cross-Strait reconciliation further irked both the KMT and Beijing (Jeffries, 2006, pp. 35-36; Copper, 2013, p. 207; Kastner, 2009, p. 35). The 1992 Consensus is a term that was coined in the run-up to the 2000 elections to refer to the tacit agreement by the semi-official participants in the aforementioned Koo-Wang talks to declare their obeisance to the One China principle. Officially, Beijing clings to its insistence that there shall be no negotiations with representatives from Taiwan unless they accept that there is only One China. A compromise was found wherein CCP representatives would declare their acceptance of One China, that being the People's Republic, and KMT representatives would do likewise, only that they would privately interpret that "One China" to be the ROC.

In 1999 and 2000, as a non-KMT president became a viable possibility, there were fears of a possible announcement of Taiwan independence. Zhu Rongji, the premier of China at the time, warned in the run-up to the elections in Taiwan that they would "not sit idly by and watch any serious separatist activity aimed at undermining China's sovereignty and territorial integrity, such as those advocating the 'two-state theory' or 'the independence of Taiwan'" (Federation of American Scientists, 2000). That statement sent from the Beijing corner of the triangle resonated loudly in the Washington vertex in 2001, when President George Bush was asked in an interview whether the United States would have an obligation to protect Taiwan should it be attacked by China. "Yes, we do, and the

Chinese must understand that," Bush answered, adding that America would do "whatever it takes to help Taiwan defend itself" (Jeffries, 2006, p. 40).

At this point, Japan makes its way into the triangle, shaping it into a tetragon, and not only because the United States has made several similar high-level commitments to safeguard Japan as well, should a military conflict (with China) over the sovereignty of the Senkakus/Diaoyus occur. The 2004-2006 period became extraordinarily heated in the Taiwan Strait:

- As Chen Shui-bian consistently refused to accept the 1992 Consensus, he was regarded in Beijing as an embodiment of the independence threat, especially before his 2004 re-election, when talk began of holding a referendum on independence;
- In late 2004, Japan issued its White Paper in which it declared China a threat (Jeffries, 2006, p. 59);
- In early 2005, the United States and Japan signed a joint security agreement, in which they committed themselves to jointly protecting Taiwan against military threats (Jeffries, 2006, p. 59);[41]
- In 2005, China passed the so-called Anti-Secession Law, which basically legitimized Chinese military intervention should Taiwan attempt to institute formal independence (Cody, 2005).

The US engagement in the Cross-Strait issue is a very important feature of the triangle: "The longtime US balancing act between supplying weapons support to Taiwan, to deter any Chinese attack, while leaving the eventual US response vague, to discourage independence-minded Taiwanese politicians, is known as strategic ambiguity" (Jeffries, 2006, p. 40). This ambiguity is easy to discern, even on the part of pro-Taiwan presidencies such as the Bill Clinton administration (Copper, 2013). The younger Bush, too, although he made vital oral commitments early in his presidency as mentioned above, also openly opposed Chen's apparent push towards independence. This is an ambiguity that stems from the 1970s and which potentially can undermine both Taiwan's and China's trust in Washington

[41] Japan's formal involvement in the security issue of the Taiwan Strait hurts historic Chinese wounds on one hand, and brings a second formal security ally on the other hand for Taiwan besides the American TRA.

in the long-run. Chen Shui-bian's assertive push to an independence-related referendum in the light of Washington's open opposition can be seen as a sign that Taiwan's political elites had had enough of lasting ambiguity. Conversely, it can be seen that the KMT has pursued a more conciliatory agenda towards Beijing from the 2000s. The historic meeting between Ma Ying-jeou[42] and Xi Jinping (Wang, 2015) point to cosy Cross-Strait ties that Washington could well perceive as being way too close.

ECONOMIC RELATIONS

Cross-Strait economic relations have been flourishing for decades, despite major setbacks in the political arena. In this regard, Taiwan shares some similarities with Japan, but as pointed out earlier, Japanese businesses suffered huge losses as a result of the 2012 countrywide anti-Japanese protests that the CCP government let unfold[43] in China. This has probably had a (Japanese) investment-diverting effect from China to ASEAN countries. Taiwan-based businesses have not experienced such hurdles throughout their operations in China before and after the Cold War era, at least not from the Chinese side. Taiwan itself restricted FDI flow to China through the 1990s under Lee Teng-hui's "No Haste, Be Patient" policy, and in a different way in the "Go South" policy (Kastner, 2009, pp. 55-60.). These policies were intended to stem the rush of high-tech investments in China, to preserve jobs in Taiwan, to protect the island's economy from a dangerous overdependence on the Chinese market, and to prohibit the spill-over effect. The latter two aims together also point out the intention to save Taiwan from China's political influence via economic links (Crookes-Knoerich, 2015, p. 9; Kastner, 2009, p. 44). Kastner concludes that there are political, rather than just economic, motivations behind the fact that China provided preferential treatment to Taiwan investors in multiple regards, e.g. tax holidays or property-transfer provisions. In 1994, a law was passed to protect the assets of "Taiwanese compatriots" from nationalization (Kastner, 2009, p. 94). In 1996, Vice-premier Li Lanqing

[42] In his first term, Ma proved handy in balancing back Taiwan in the triangle by regaining the momentum of rapprochement with the mainland while also sealing a US$6 billion arms deal with the United States. (Copper, 2013, pp. 61-63)
[43] ...or even organized them, according to some, like Chinese artist Ai Weiwei. (Connor, 2012)

said: “the purpose [of preferential policies] is to give absolute guarantee to the interests of Taiwanese businesses in China, so that they can develop confidence in the long-term development of their mainland investments. This policy originates out of [China’s] broad national interests.” The president also saw economic integration as a means to a later unification (Ibid. p. 94). Beijing always remained consistent with its communications to safeguard Taiwan-based businesses, no matter how tense political frictions might turn.[44] The process of in-depth integration of entire sectors into China’s economy was certainly supported by a firm and welcoming stance from Beijing’s side. One spectacular representation of how deeply the numerous Taiwanese businessmen became engaged in China is the widespread network they were able to build within the administrations of the South-Eastern provinces—Fujian in particular. Kastner adds that applying economic sanctions in a tense Cross-Strait political situation would be costly for Beijing, and thus it would be a last resort (Ibid. p. 92-93). Economic links intensified during Ma Ying-jeou’s two terms (2008-2016). Under Ma’s presidency, two important trade and investment agreements were concluded between the two sides of the strait, while the failure to pass the third marked a drastic decline in public support for his policies amid an economic slowdown and fears over increasing Chinese influence in Taiwan. The three agreements are:

- 2010, Economic Cooperation Framework Agreement (ECFA), which came into effect in 2010 and lifted or decreased the level of tariffs on a wide range of traded products. It is regarded as a formal manifestation of the already sprawling trade links (Crookes-Knoerich, 2015, p. 7);
- 2012, Cross-Strait Bilateral Investment Agreement (BIA), which is an investment promotion and protection agreement. It enhanced the legal framework for Taiwanese investments in China, but also covered the legal stance of Chinese investments in Taiwan (Crookes-Knoerich, 2015, p. 8); and

[44] With the partial exception of the so-called green businesses that were occasionally harassed or more closely monitored if their owner openly supported a DPP candidate in the election campaigns. (Kastner, 2009, pp. 96-99)

- 2014, Cross-Strait Service Trade Agreement (CSSTA). Its rather dodgy preparatory phase engendered extended opposition throughout the island, and sparked the emergence of the Sunflower Student Movement (Cole, 2014).

This latter case was the first time that Cross-Strait economic issues, which had previously been seen as "easy questions" as opposed to the "deep water" quagmire of political questions, sparked wider and deeper public concern in Taiwan, potentially marking the start of a new era in Cross-Strait relations. In January 2016 the DPP gained the majority of seats in the Legaslative Yuan for the first time in history, which could potentially mark a larger-scale political turn in Taiwan. Big questions rise, whether the new president, Tsai Ing-wen can consolidate the DPP's power in the longer run? Can she possibly revive Taiwan's economic growth without too much economic and political compromises with the Mainland? As for her records, Christian Göbel of the Institute of East Asian Studies at the University of Vienna underlined,[45] that she is known for her pragmatic approach, and he cited the period of 2000-2004, when Tsai was the minister of the Mainland Affairs Council (MAC), and economic Cross-Strait relations prospered.

DEMOCRACY AND IDENTITY

As Copper (2013, p. 228) points out, Beijing has declared its intention to use armed force to annex the island if Taipei allows foreign bases or foreign control of any or all of its territory; builds nuclear weapons; experiences internal turmoil; declares independence; or refuses to negotiate unification over a long period.

In addition to the extreme vagueness of the phrase "over a long period," the interpretation of "internal turmoil" began to sound more ominous after 2014, because the protesters of the Sunflower Student Movement occupied the Legislative Yuan in Taipei. This is not to suggest that the movement would trigger a military response from Beijing—it manifestly did not—but it must be emphasized that, in light of any similar future protests in

[45] Roundtable discussion held at Central European University in January 2016.

Taiwan, such a scenario cannot be ruled out.[46] This is especially true since China sees the DPP, which regained the ROC presidency in 2016, as being supportive of the Sunflower Student Movement, and as being the single greatest hurdle to unification. The military capacity of China's People's Liberation Army (PLA) long ago outpaced that of Taiwan's military, and even the island's deterrent power is not comparable to Chinese combat capabilities, except with full US (and Japanese) support. Taiwan, however, developed a weapon almost as sharp as the Chinese military might: democracy.

After Washington switched diplomatic recognition from Taipei to Beijing in 1979, "Taipei adjusted by democratizing its political system along lines suggested by Washington, and, as it did so, it let Washington know" (Copper, 2013, p. 200). Opposition parties were allowed to operate from the 1980s, and in 2016, the 20th anniversary of the first free elections were celebrated in Taiwan. The country's democratic political transformation has given Taiwan multiple assets:

1. With the democratization process, the island's political landscape has been torn into basically two halves: one, led by the DPP that pursues genuine independence, and the other, championed by the KMT, (officially) striving for a unification of China, originally under the administration of the ROC. It is not inconsequential that Beijing sees the DPP-led camp as the depositor of anti-mainland rebellion, since the KMT's image greatly rose as the standard bearer of Dr. Sun Yat-sen's legacy, who planned to introduce a democratic system to China in stages (Encyclopaedia Britannica, 2016c). As long as Taiwan was under authoritative rule, the KMT had little moral authority to insist on a possible unification scheme characterized by democratic features. But with decades of an established, smoothly-working democratic system behind them, the current governing party of Taiwan can confidently refer to Sun's ambition and insist on democratic preconditions to

[46] During the turmoil surrounding Taiwan's 2004 elections, China issued a harsh statement: "We will not sit by watching should the post-election situation in Taiwan get out of control, leading to social turmoil, endangering the lives and property of our flesh-and-blood brothers and affecting stability across the Taiwan Strait." (*China Post*, 2004)

unification. This would be an as-yet immeasurable asset at the KMT's disposal, should it return to a governing position. The KMT has led Taiwan into becoming a prosperous nation, economically as well as politically developed. By leveraging this record, it is not unreasonable to predict that the party would enjoy widespread support in a democratic China.

2. Having emerged into a mature democracy under the American security umbrella, Taiwan has become a precious jewel that the United States can show off in its display vitrine, further evidence of how Washington likes to champion itself as a global guarantor of democratic values. Taiwan's democracy represents a significant potential for leverage, and is something that Washington would pay a high price for, should it be allowed to vanish.
3. The emergence of a Taiwanese identity: the establishment of democracy undoubtedly created the conditions for the free expression of self-perceptions of Taiwaneseness. Examining the polls on identity that have been consistently conducted through the years, a constant, strong preference for a Taiwanese as opposed to a Chinese identity becomes evident, a process which is amplified by technological development (Crookes-Knoerich, 2015, pp. 147-161.). This strengthening Taiwanese identity is a factor behind Beijing's desire to accelerate the unification process. Simply put: the longer unification is delayed, the more difficult it will be for Beijing to integrate Taiwan.

The situation, however, is more complex. The first asset enumerated above (namely, democracy) would be mostly useful for the KMT, while the third works mostly in the DPP's favor. The second is an external factor on which Taiwan has little impact. Moreover, the CCP can play the first two off against the third. Democracy is a double-edged sword that provides room for all the often countervailing forces that have been introduced above to prevail or fade. In the mid-2010s, all the major forces that have been shaping Cross-Strait relations for the past 70 years seem to have coalesced. As Goldstein notes (Crookes-Knoerich, 2015, pp. 32-33.), the "equilibrium" in the Taiwan Strait does not mean stability, because the long-term interests of the sides are different. Upholding the *status quo*—which

Goldstein describes as being in a sensitive equilibrium—must be the dedicated political aim of newly elected ROC President Tsai Ing-wen. This will, however, become much more challenging amidst an increasing Sino-American regional rivalry, tense Sino-Japanese political relations, an ever-evolving Taiwanese identity, and intensifying Cross-Strait economic integration. A constructive approach to economic and political issues from all sides is likely to become more important in upholding the peaceful development of the Cross-Strait relationship as well as the broader East Asian region, than sheer pragmatism.

Conclusion

The current paper set up a basic theoretical framework for research on Cross-Strait relations, and with regard to the broader Far Eastern region. Such a multilateral framework requires a coherent structure involving multiple contexts. Those contexts were chained along a timeline starting from the Cold War era in East Asia. The major focus has been put on the geopolitics of Taiwan, the evolution of which has been placed into a number of contexts: historical, political in the narrower sense, economic, and to a certain extent, sociological. Geopolitical contextualization covers the Washington-Taipei-Beijing triangle, the changes in the "resonating" potential of the three vertices after the Cold War era, the broadening of the triangle with Japan to a tetragon, as well as regional and global developments deemed essential. Lastly, three areas may be identified for potential further and deeper research.

Kastner's pioneering case study (2009) on the correlation between Cross-Strait economic integration and the political environment is an excellent base from which the depths of Cross-Strait — and the wider East Asian — economic integration can be studied further. (1) An important direction in doing so would be the development of a thorough understanding of the role of large MNCs on both sides of the strait, with a special focus on those from Taiwan, China, and Japan. Such MNCs are important because they form the centres of highly integrated supply chains in East Asia, yet their effective political leverage in the countries involved is difficult to assess, and also remains woefully under-investigated.

As has been pointed out, after WWII, the dominant Western European countries (including the United Kingdom, Germany, and France) followed a Cross-Strait policy dictated basically by Washington. With these countries joining the Beijing-led AIIB as founding members in 2015, a picture emerges of a more self-conscious Europe regarding East Asian politics starting to unfold. The largest EU-member nations, however, tend to deal with Beijing individually, sealing deals worth billions of Euros, in a process that follows a pattern similar to how European powers once "shuffled their cards" in imperial China. A fragmented European Union incapable of exerting its economic might in the political sphere and thus contributing, for example, to the peaceful development of Cross-Strait relations — in the interests of all European nations — represents an unquestionable asset for Beijing in the long run. The European Union will not rise as a unified power any time soon, or take on a more active, conciliatory role in the East Asian region. Nor is it certain that it should even attempt to play the latter role. What is certain is that EU countries should learn from the lessons of history, and be aware of their shared interests in East Asia. (2) Further research should highlight those core, shared interests[47] that the EU potentially can act on when participating in Beijing's initiatives, such as the OBOR trade program.

The most exciting, most ambitious, but also most dubious research (3) would be to define, and to the closest possible extent quantify, those major factors that best describe the trauma of the Second World War and the conflicts that followed (i.e. the Chinese Civil War, the Korean War) and which contributed to the features of the East Asian region as regards the relations between China, Japan, Taiwan, and the Koreas. Although there is little doubt that the countries' political behavior towards each other bears the scars of the 20th century's historic traumas,[48] it remains a relatively poorly studied area of research in the West. If those factors, however, could be seized upon, there would be a chance to actually measure their impact on the development of foreign relations in post-war

[47] Including the peaceful development of the East Asian region.
[48] Consider the disputes on the content on Japanese history books, the issue of comfort women, the Yasukuni shrine, the sweeping anti-Japanese riots in China in 2005 and 2012, etc.

East Asia. If there are chronological patterns to be drawn, these can be compared with findings of the regional (China-centred) economic integration process, an area where East Asian nations show similar tendencies with different characteristics. The question of main interest would be whether and to what extent collective national traumas have any relation with the speed, depth, width, and pattern of the integration of the relevant economies – in the case of the Taiwan-Strait, broader East Asia, and also Europe.

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INTERNATIONALIZATION OF EU SMES IN CHINA

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The favourable development of economic relations between the European Union and the People's Republic of China necessarily requires both partners to put the internationalization of small and medium-sized enterprises – that constitute the bulk of business entities – on the agenda. This paper aims to investigate this issue from the EU point-of-view thus summarising the opportunities and challenges of establishing business relations with the world's largest consumer market and further determining the typical features of the Chinese business environment regarding market entry forms as well as highlighting examples of the largest EU partners to the Far-Eastern country. By providing a theoretical background on the internationalization of small companies the report allows the reader to assess the EU's and its SMEs' chances, competitiveness in China.

Theories of entry modes

Small enterprises often suffer from the lack of resources and due to the fact that entering a foreign market needs capital injection, they have to choose a strategy that enables them to successfully cope with this restriction (Tayeb, 2000, p. 200). In the following, the three most important concepts of market entry from the SMEs' point of view will be introduced.

THE UPPSALA MODEL

Having built a reputation in the domestic market and thus raising enough capital, enterprises might start to look forward to other possibilities for growth in the international market. The incremental way of opening towards foreign markets is interpreted by the Uppsala or Establishment Chain Model, which assumption was developed by Johanson and Vahlne in 1977 (Johanson et al., 2009, p. 1411). This theory also describes well the situation of small companies as it builds the process of internationalization on information possession. When SMEs decide to go abroad they face the problem of the so-called psychic distance. The idea of this lies in the fact that culturally diverse nations have different educational, political and legal systems as well as speaking different languages. The process is built on four stages and the SMEs develop their scope of business once they become familiar with and have completed the previous stage. First, by reason of low resource commitment the exporting activity of companies is infrequent, and then they conclude contracts with agents as well as exercise their exports via their services. Next, companies usually establish subsidiaries in their target countries so as to be more responsive to the local needs and finally they start their production in place. Although the Uppsala Model has received much criticism, several studies have confirmed that SMEs are likely to choose this stages model of internationalization as they rely a lot on the consideration of their limited resources and their capability to expand (Tayeb, 2000, p. 205).

THE NETWORK MODEL

In their revised model, Johanson et al. (Johanson et al., 2009, pp. 1411-1413.) argue that due to changing business practices it is no longer physic distance that hinders companies to internationalize but the problem of not belonging to networks raises a greater concern. Furthermore, the economists suggest that having several interconnected business relationships is associated with market knowledge and trust acquisition. Technological, trade or other relations with the actors of a network allow gradual internationalization thus the concept of the network approach exhibits the other corresponding theory to internationalizing SMEs. Accordingly, relations and contacts highly influence an enterprise in its decision to go abroad and it enters a given market because its partners operate in that particular market. Networks can be organized either horizontally or vertically. The former applies to situations when the enterprise comes to be the part of a network of firms providing competing goods or the enterprise is doing business with entities engaged in other industries. The latter occurs among a company and its supplier or its consumer. In general, four stages of the network internationalization model are identified. Companies are early starter, lonely internationals, late beginners or they internationalize incidentally. Enterprises that are in the early starter phase have only few relations with other foreign counterparts, so their internationalization process is very similar to the Uppsala Model – in order to reduce risks, they first start to expand at near markets. The so-called lonely internationalizing firms are also at an early stage and lack the number of international contacts but they achieve high degree of internationalization on their own. The late beginners' main stimulus for internationalization derives from their customers, suppliers or competitors as all of them are carrying out a high degree of foreign trade activity. Those companies – the so-called internationals among others – whose internationalization is incidental operate on a global scale mainly with the aim to coordinate the market; consequently, this type of network model is applied rather by larger firms than by SMEs (Tayeb, 2000, pp. 206-207.).

INTERNATIONAL NEW VENTURES MODEL

The third approach to international market entry is the International New Ventures or Born Global Theory, which is contrary to the incremental and slow Establishment Chain Model. Breat (Breat, 2009, p. 301) regards Oviatt and McDougall as the founders of this approach in which the authors define international start-ups as companies that seek to exploit the competitive advantages from the fact that their resource utilization and sales are related to many countries. In contrast to the Uppsala Model, born global companies often leave out certain stages or they apply more stages at the same time. In many cases they start international activities in parallel with their foundation. The fundamental aim of born global companies also differs from the one of incremental internationalizing companies. While the former's goal is development, enterprises in the Uppsala Model rather concentrate on survival (Tayeb, 2000, pp. 208-209.). In the current globalized world, there is a common tendency of companies being international from the beginning. Generally, high-tech and telecommunication companies follow this internationalizing behaviour: SMEs engaged in these fields excel in recognizing market niches and due to their innovativeness they are highly adaptable to challenging environments (Breat, 2009, p. 302).

Obstacles to the SME internationalization

BARRIERS IDENTIFIED BY THE EU

The European Union views positively the Chinese government's steps taken to the facilitation of trade (of which results can be mainly seen in the service and investment sectors). Although China has introduced more measures with respect to trade liberalisation than any other country still for European companies it is not easy to survive in the Chinese market. Besides which European enterprises face market entry barriers, they are allowed to operate in many Chinese sectors only if they merge with a local firm. Problems are also described regarding the transfer of technology as well as discriminatory practises are often carried out subsequently by introducing a new regulation. These actions of the Chinese authorities go against the Far-Eastern country's commitment towards operating as an open economy. For instance, usually the Chinese government justifies its vague restrictions on foreign direct investments by the protection of national security such as in areas banking and insurance activities. Some of the major concerns of the EU are the following (European Commission, 2016, pp. 11-12.):

- Even the food sector is strictly controlled by the EU, China restricts the importation of e.g. dairy, meat products
- Trade barriers exist for medicines and medical devices
- The Commission states that the registration of cosmetic products is burdensome
- China's laws on government procurement are still not in line with the WTO scheme thus for European companies it is difficult to access Chinese tenders

The European Commission (European Commission, 2015, p. 8) states that two concerns: the extent of corruption and the violation of intellectual property rights are attributable to China's regional differences. While in the developed cities law enforcement is executed properly, in the provinces these problems still persist.

Corruption might pose significant burden on internationalizing SMEs. In China, this political risk is given primary concern and it is considered as the riskiest practice for foreign businesses. Small-sized companies are more vulnerable to this risk than multinational firms as the latter have enough capital to successfully exist in such an environment (Tayeb, 2000, p. 255). Transparency International (2016) ranks the Far-Eastern country in the middle of the range (83 out of 168) while giving China a relatively low score, which suggests that its government-operated sector is considered to be highly corrupt. Moreover, in 2010 the State's measures taken to curb corruption were perceived to be ineffective as the Chinese government's engagement in controlling corruption was only 33%.

"In the official statistics of the European Commission on customs enforcement of 2013, according to which 66.12% of the goods detained in 2013 at EU borders due to suspected IPR-infringement originate from mainland China, and another 13.31% from Hong Kong, China" (European Commission, 2015, p. 7). By intellectual property we mean of the figments of the creative mind that are subject to legal protection. These trademarks, patents or copies include inventions, literary and artistic works as well as logos, names, images used in trade of which rights are also incorporated into the Universal Declaration of Human Rights. The first steps towards the protection of IPR were taken at the end of the 19th century when the Protection of Industrial Property (1883) was declared in Paris (WIPO, n.d., p. 3).

The Chinese government is determined to overcome the breach of intellectual property rights by 2020. It announced a strategy on protecting IPR rights the so-called 'National IP Strategy' in 2008, which further has been built in its 12th Five Year Plan. Cooperation on IPR issues between the European Union and the People's Republic of China dates back to 1995 and since then dialogues on intellectual property are held on a yearly basis either in Brussels or in Beijing. One part of the dialogue covers working groups, which represent a more sector specific approach to the topic. Although the European Commission highly values the importance of this dialogue in the EU-China economic/commercial relations and also recognizes it as a positive progress in China's safety measures on IPR, it still raises concerns because nearly three forth of European companies in

China claim that they are badly affected by the violation of their intellectual property rights. (European Commission, 2015, p. 6-8) On the other hand, the survey of the Swiss Centre in Shanghai states that even most of the breach of IPR occurs in China, foreign companies are not seriously affected (only up to 14% of the interviewed European enterprises claimed that their stolen IPR rights caused grievous loss to them) and in fact, the Chinese enterprises are more exposed to this problem than their foreign counterparts as well as businesses similarly face this crime during their operation in all countries of the world (Musy et al., 2015, p. 32-33).

CHALLENGES THAT EU SMES FACE

In the following, principal impediments that make entering the Chinese market more difficult for internationalizing European companies will be introduced based on a comparison scheme according to surveys taken out by chambers of commerce whose members are mainly small and medium-sized enterprises.

Rising labour costs ranks much ahead in the main challenges identified by enterprises of the major EU exporters to China. In addition, the second most frequent problem is also associated with employment that is finding the best qualified workforce, so it can be concluded that human resource issues exhibit a source of problems for businesses originating from Germany, Britain, France and the Benelux States. Also, European companies are apprehensive of China's economic slowdown. Generally, they are concerned with the macroeconomic changes in the world, the global economic decline. Besides these challenges, the European Chamber of Commerce (2015) identified increasing competition coming from the stronger position of Chinese private firms – although the Chinese SMEs are also affected by the macroeconomic changes of the world they are not restricted by different market entry barriers as their foreign counterparts. Moreover, both risks associated with currency as well as burdensome administrative procedures confirm the less-investor-friendly nature of Chinese regulatory environment. Furthermore, the German Chamber of Commerce in China (German Chamber of Commerce in China, 2015, p. 12) outlined the challenge of slow internet and internet censorship. China lags behind the US and the EU concerning the rate of internet users and although there is a steadily growing tendency in their number, in 2014 less than 50% of people had internet connection (The World Bank, 2016).

Table 1. The 5 main challenges of companies of major Member States expanding to China based on surveys conducted by chambers					
	EUCCC (2015)	German CCC (2015)	British CBBC (2013)	French CCIFC (2015)	Benelux CCC (2015)
1.	Chinese economic downturn	Getting skillful employees	Bureaucracy	Rising labour costs	Rising labour costs
2.	Global economic downtrend	Rising labour costs	Rising costs	Getting skillful employees	Managing sales volume/ meeting sales targets
3.	Market access obstacles	Retaining the skillful personnel	Getting skillful employees	Chinese economic downturn	Managing 3rd parties
4.	Rising labour costs	Currency risk	Legal environment	Late payments	Managing regulatory compliance
5.	Competition	Obstacles in administration	Corruption	Global economic downturn	Managing material costs
Source: own illustration based on European Chamber (2016, p.15), German Chamber of Commerce in China (2015, p.12), CBBC et al. (2013, p.18), CCIFC (2015, p.14), M. Vos (personal communication on the results of Sino-Benelux Business Survey, 26 August, 2016)					

Enterprises, regardless that they are multinational, small and medium-sized or micro companies might be seriously affected by the host countries', sometimes unpredictable, political and social systems – this is true for China as well. Country risk might include those discriminatory measures against foreign investors that are imposed, for instance, in the form of taxes, financing restrictions, controls on the access to foreign currencies and expropriations. Moreover, local people's prejudice against foreign products and services as well as their dissatisfaction with their country's regime might threaten foreign-owned businesses (Tayeb, 2000, p. 258). When country risk is confirmed, in unfavourable circumstances SMEs (being unable to have an effect on the external environment as well as facing the problem of lack of resources) often become forced to abandon their operation. The third main challenge identified by the European Chamber of Commerce (2015) namely the market access obstacles are examples of the non-tariff barriers levied by the Chinese government. Coping with the problem of corruption was reported only by the British enterprises to be among the main challenges in 2013. It was not included in the most recent surveys of 2015 although there were doubts on this topic from the part of the Union.

In addition to the above mentioned international business-related challenges, SMEs expanding to China have to face difficulties arising from cultural and language barriers even at the earliest stage of their internationalization. European businessmen should consider cultural differences of high importance otherwise misunderstandings; uncertainties might hinder the development of their business in China. For an enterprise going global it is essential to build a reliable network of relationships, which in China starts with building trust (EU SME Centre, 2013, p. 2). Hofstede's (2001) dimensions perfectly describe those striking cultural differences between the European and Asian perceptions that must be taken into account when doing business with each other. Whereas the Europeans are striving for equality, the Chinese accept inequality and hierarchy, which suggests that in business life, subordinates are very dependent on their superiors. Also, opposed to the European individualistic society, China represents collectivism meaning that family-structured SMEs are very common (in the Chinese culture, the familial ties play an important role) as well as delegations containing a great number of people to negotiate with foreign companies. The EU SME Centre (EU SME Centre, 2013, p. 7) suggests that the European parties should be patient in establishing any relationship with the Chinese counterparts, but once a trust-based connection is formed, it will last for a long time – although special attention should be given to nurturing of the relationships.

Despite the above mentioned discrepancies European countries and China have common values as well. All of them are success-driven societies, which derive from their masculine cultures. In addition, having a high score in the long-term orientation, they are declared to have pragmatic cultures thus having strong inclinations with regard to savings and investments and diligence to bring successful results (Hofstede, 2001).

According to Tayeb (Tayeb, 2000, p. 521-522) the Chinese business style originates from the country's system of communism, populous nature and continuous reforms. In the past, the communist regime brought about an underdeveloped nation with technology, infrastructure, education and living standards lagging behind. However, due to China's opening-up-to-world-markets, reforms, and the positive effects of globalization have moved the Far-Eastern country's development forward. Chinese businessmen have become more international, more adaptive to foreign cultures and more open to communicating in English.

Motives of SMEs to go global

The European Parliament (2016) argues that apart from the challenges of going abroad, internationalization is useful and has a variety of opportunities for small and medium-sized companies. Besides having productivity gains, enterprises operating in foreign markets achieve higher innovation and create jobs.

Usually, the literature divides internationalization motives into internal and external factors. The former is often stimulated by the role of the management, organisational (market-, efficiency- and resource-seeking) motives and by the fact that the company have already achieved success in the domestic market. Among examples for the latter are unsolicited proposals, the bandwagon effect and the increased penetration of foreign enterprises to the domestic market, which results in competition. In most of cases, not only a single internal or external factor influences a company in its decision to internationalize but the combination of different drivers (Tayeb, 2000, pp. 131-133.).

As this paper aims to investigate why European SMEs internationalize in China and not elsewhere only the analysis of the following motives will be implemented: out of organisational factors the market-seeking motive is the most relevant regarding SMEs because efficiency as well as resource-seeking motives are more likely to apply to large multinational firms. As for the external factors, unsolicited proposal and the bandwagon effect will be determined.

MARKET-SEEKING MOTIVE

In a report, the OECD (OECD, 2009, p. 12) summarized its members' main motives of expanding beyond their home countries. Several European SMEs from the Benelux states, France, Germany, Poland and Spain designated market position, knowledge- and relationship seeking drivers while UK-based enterprises were more interested in achieving higher profits as well as the advantages offered by the market size.

Morschett et al. (Morschett et al., 2010, p. 72) states that foreign companies are ready to export or invest in countries which are experiencing a significant economic growth and have appealing customer segments if they face many competitors in the domestic, saturated market. For this reason, developing populous nations such as China, India and Brazil are potential targets for many enterprises. However, a country with a large population does not always mean one achieving huge sales volume: due to regional disparities only a certain percentage (20-30%) of Chinese people can afford Western goods and services (Tayeb, 2000, pp. 133-134.). Recently though in China, the rising of the middle class has resulted in a higher number of Chinese consumers able to purchase European products (Tichauer, 2015, p. 16).

The market-associated intentions of opening up to international markets do not necessarily mean that the enterprise will invest in the given country. In many cases, only exporting will take place on account of this activity involves reduced costs and risks (Morschett et al., 2010, p. 72).

UNSOLICITED PROPOSAL

Small companies might decide to internationalize when they receive an unsolicited proposal from a Chinese counterpart, distributor or customer. In this case, first they assess risks and the potential opportunities in entering a foreign market. There is a tendency that small companies are usually deterred by the geographical distance as well as by the different cultures and languages therefore, it is reasonable to conclude that this is often a reason why only a small proportion of European companies internationalize in China. Of course it is evident, if the company accepts the foreign proposal it can only succeed if its management is highly committed in this manner organisational factors come into view (Tayeb, 2000, p. 136).

BANDWAGON EFFECT

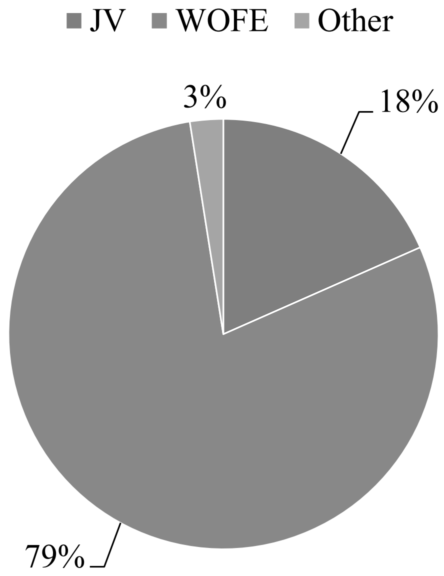
Another external stimulus received by the company can be explained by the so-called bandwagon effect. This psychological phenomenon is driven by the competitive behaviour of firms: they perceive that if they do not keep up with others they might lose advantage. In other words, the success of one firm has an influencing effect on the others thus motivating them to bringing about the same decisions. Tayeb (Tayeb, 2000, p. 137) raises the example of Western enterprises entering in China when it started to open up to world markets. Similarly, when the Tiananmen massacre took place in 1979, many European companies felt that their competitive advantage multiplied if they carried out operations in Mainland China because at that time the investor behaviour of the majority subsided. Also, internationalization is not only explained by following one's competitors but one's customers. 'Following a customer overseas might be necessary to protect existing sales levels or it can be an opportunity to enhance sales if the customer increases its production with the new foreign facility' (Morschett et al., 2010, p. 74).

Legal forms of market entry

Any enterprise that aims to enter markets beyond its own country should consider laws and legislation – in the case of the People's Republic of China this is a complicated issue. According to 'Ease of doing business in China' report, China ranked 83 among the 189 surveyed countries (The World Bank, 2016); supposedly, this complexity might deter European SMEs to establish an office in China. Generally, two ways of penetrating into international markets can be distinguished: first a company might become an exporter or a contractor, representing the non-equity type of market entry and second it might undertake investing activity, which is called equity-investing mode of entry (Tayeb, 2000, p. 156).

Usually, SMEs can be contracting parties of large enterprises as suppliers, but if they are from developed countries they usually became transnational on their own account (Asian Development Bank Institute, 2015, p. 16). Currently, foreign enterprise presence in China might occur in three distinct forms. Foreign entrepreneurs or businesses might either establish wholly-owned foreign enterprises or might merge with a Chinese partner thus creating a joint venture. Second, they might found foreign-invested partnerships and also, opening a representative office would be an option (EU SME Centre, 2015, p. 7). The vast majority of investors decide to form a 100 per cent foreign enterprise within the framework of the Chinese law, while the second most popular foreign invested company form is establishing a joint venture.

Figure 1. Total foreign direct investments in China by forms in 2014



Source: Calculations based on National Bureau of Statistics of China, 2015

NON-EQUITY INVESTING TYPE OF MARKET ENTRY

Cross-border selling has an increasing importance in our world and since the evolution of international and regional trade negotiations the protectionist barriers of countries have been reduced further enhancing the globalisation of world trade. As a result, there is a growing tendency that exporters distribute their products on international markets (Tayeb, 2000, p. 158). The Chinese regulation on imported products can be divided into five categories: prohibited goods, restricted goods under tariff/quota limits or subject to licencing and commodities that can be only imported by commissioned companies. Unfortunately, there are no uniform standards as they vary from local to national levels (EU SME Centre, 2014, p. 4).

According to Chinese law, only those enterprises are allowed to import e.g. European goods and services that have the adequate permission to carry out cross-border trading. These companies although are often not selling the imported products directly to Chinese end-users but they only have an intermediary role (EU SME Centre, 2014, p. 4). In case of indirect exports, the company will not be in direct contact with the importing country's market. In general, enterprises sell their goods to intermediary traders giving free hand to them regarding the further trading of the products. Usually, the mediating role is implemented by piggyback exporters, export/ confirming or buying houses, respectively distributing the goods using the already established network of the larger foreign company, purchasing the domestic firm's product for sale abroad thus bearing the risks and buying up the domestic company's goods under foreign command (Tayeb, 2000, pp. 159-160.).

Embassies or chambers of commerce are in continuous contact with agents and tradeshows, offering the possibility for SMEs to choose a distributor. Usually, European SMEs are advised to conclude contracts with more than one distributor so as to avoid dependency. In China, agents are not able to enter into a contract of employment, but should provide their services in the form of their own enterprise (EU SME Centre, 2015, pp. 10-12.).

Indirectly selling to foreign markets requires only minimum engagement from the part of the exporter company. On the one hand this is an advantage, on the other it does not allow the enterprise to set up a long-term presence in the foreign market. For the former, benefits include less risky transactions, the rapid distribution of products through the channels of an already existing well-functioning network and no financial contribution to exporting, while the latter suggests the lack of control over the selling process itself, no information about the international market as well as no intention to develop. A company, which is more enthusiastic about penetrating into certain markets, will sell its goods or services directly. Direct export is a form of market entry in which the company markets its products (whether it is business-to-business or business-to-customer transaction) on its own account in the foreign market. This phase is much more costly and bears a higher risk but also increases the profitability. Moreover, being present increases its familiarity with the target market (Terpstra et al., 2012, pp. 8-9.).

Licencing is a more developed way to enter the market than exporting. In this non-equity form of deal, the foreign enterprise transfers the right of using its proprietary know-how, which can be patent, copyright or trademark (collectively known as intellectual property right) to another company. The rights are ranging from designs to quality control processes, product descriptions and sales promotion materials. Usually the counter value of technology remunerated by the receiving party is a predetermined amount of money called royalty. Royalties might be paid in several ways. In most cases, the licensor imposes a minimum compensation on a yearly basis although continuously paid royalties are more advantageous: they are determined in a certain percentage of the selling price guaranteeing mutual benefits for both parties thereby ensuring the best performance-related gains. Generally, licences are restricted to a particular territory, which might denote a disadvantage for the recipient. Also, the danger of the licensee becoming a competitor persists in this case so precautionary measures concerning IPR issues should be taken seriously, especially in the People's Republic of China (Tayeb, 2000, pp. 162-163.).

Even if licencing is common amongst multinational enterprises it is not only they might export their product and service licences to international markets, this opportunity is also a niche segment available for SMEs, too. According to data collection of the EU SME Centre (EU SME Centre, 2015, p. 16) most of the licences are granted in the People's Republic of China and this tendency increases yearly by more than 15%.

In addition to a licencing agreement that is authorizing the use of one's products or brands under certain conditions, franchising provides the transfer of the full know-how. Accordingly, in the case of a franchise settlement it is the essential knowledge, the proven technology and the procedure which are of high importance. Usually, the purchaser (franchisee) of a franchising contract receives assistance for its operation from the franchisor and at the same time it enjoys the benefits of distributing under an already recognized brand name. Still franchisees of the host market might disagree with the terms of such a contract as there is lose supervision and control from the part of the franchisor (Tayeb, 2000, p. 164).

The franchise business form first appeared in the People's Republic of China in the early 90s, when large multinationals (e.g. McDonald's) penetrated into the country. However, franchising is mainly popular with large companies and among small and medium-sized ones franchising mode of foreign market entry is less significant. Even the largest franchisors are foreign large enterprises (once they were also SMEs), most often the franchisees are run by small businesses. Usually, if a franchise agreement is undertaken overseas franchisors often prefer contracting local franchisees in order to benefit from the local advantage. Generally, the most popular service industries in which franchises operate are the food and catering sector while others are related to beauty salons, education and interior design (Alon, 2012, pp. 109-111.).

China's law on franchising, which addresses both foreign and domestic franchisors, stipulates that only longstanding companies can take up this activity that have more than two stores operating for over a year. Also, foreign enterprises that already have a foreign-invested entity in China are able to start franchise relationships. Besides this requirement the companies are obliged to supply technological assistance and must promote the development of the franchisees' business by offering them various trainings – this suggests that the Chinese government's aim with this regulation is to ensure foreign companies' long-term and value added engagement in China (EU SME Centre, 2015, pp. 16-17.).

Companies should choose this type if they consider the Chinese market from the export point of view or try to get suppliers and they do not want to rely on a Chinese trade representative. The responsibilities of a representative office include building and nursing business relations as well as engaging exclusively in advertising. Considering the limitations of RO, in the medium-term, the foundation of a subsidiary might be a better solution, which is entitled to carry out operational activities as well (Tichauer, 2015, p. 48).

Article 14 of the law on representative offices of foreign enterprises stipulates that representative offices are not considered to be legal entities and thus only permitted to complete activities such as market research, the promotion of the parent company's goods/services as well as they may also play an intermediary role in connection with the sale of the products. Representative offices are prohibited to carry out direct business activities and accordingly to generate profit. In addition, only enterprises operating for two years are allowed to establish a RO in China. Apart from the verification of the two-year functioning period, enterprises are required to submit application documents for proof of address, creditworthiness, association memorandum, the resumes of representatives and the power of attorney of the parent company for employing representatives as well. ROs' employment is restricted in a way that only four representatives (including the principal representative) are allowed to be occupied and the office must employ only Chinese representatives by making use of the service of certified Chinese human resources enterprises. Article 12 of the regulation on the representative offices excludes hiring representatives who might cause a threat to the public interest, who worked for a RO that had to be eliminated because it meant harm for the public security and who are defined by the State Administration for Industry and Commerce (State Council of the People's Republic of China, 2010).

EQUITY-INVESTING TYPE OF MARKET ENTRY

The People's Republic of China acts very strict when it comes to the allowance foreign investments into the country, as it regards domestic industries of high importance. Therefore, it determines three categories of industries: encouraged, restricted and prohibited ones. The Chinese government ensures special treatment for e.g. enterprises supplying new technology (especially green technology), offering environment-friendly/pollution reducing/energy saving services and also for companies, which might replace badly performing sectors under state control, for instance construction and health sectors. By contrast, restrictions (which result in burdensome administrative procedures as well as set the condition that the Chinese partner should be the majority owner) are put on sectors such as banking, manufacturing, energy source supplies, telecommunication and wholesale/retail. In 2015, the number of restricted industries accounted for 38, which have fallen by half compared to the previous period. Despite this fact, the improvement in this context might not be a motivator for foreign enterprises as the access to China's market

still raises many obstacles. Finally, we differentiate industries where the functioning of foreign enterprises is banned. Prohibition inter alia applies to the internet publishing sector, tobacco sale, and cultural industries. Foreign companies must not create a social survey in the country, must not create a news portal, must not provide business services helping Internet access and mapping based on aerial photographs and producing electronic navigation maps is also prohibited (NDRC et al., 2015).
The law on wholly owned foreign enterprises locating in Mainland China requires them to have a positive effect on the country's development thus they must bring about considerable economic outcomes. The People's Republic of China prohibits any foreign enterprise that might operate against public interest, national security, laws and regulations and what is more, companies polluting the environment during their activity are banned from the country. For the registration of a wholly foreign-owned enterprise one will need an application form, the company's articles of association (in Chinese, a realization plan, the WOFE's legal representatives' name (might be in English but the translation into Chinese required), a creditworthiness report and the company's import need should be declared regarding goods and materials together with the consent of the Chinese local government on its establishment. The Chinese government promotes the exporting intention of foreign owned enterprises, which are obliged to plan exports for a year and should also apply for export licences every half year. Additionally, the companies must provide data for statistical purposes (State Council of the People's Republic of China, 2014).

The essence of this strategy is that a foreign and a domestic enterprise or several enterprises form a new company. The common feature of the joint venture lies in the shared ownership and control, meanwhile the company with capital investment takes a long-term position in the new market. Among foreign companies that wish to cooperate with a Chinese partner there are many small and medium-sized ones, which usually take advantage of their know-how and enter the market with reduced start-up costs (Tayeb, 2000, p. 173).

There are two different forms of joint venture capitalization: equity and contractual ventures. The former is a limited liability corporation of which risks and profits are equally distributed among the equity holders. The latter is a formation based on either a contractual agreement or an integrated compromise (between a foreign company/organisation/individual and a Chinese company/organization) with a limited liability company. In the case of contractual joint ventures, the risks and profits are not equally shared by the stockholders (EU SME Centre, 2015, p. 23).

Establishing a joint venture in China either means a direct benefit to the participants or in certain industries there is no legal possibility for the foundation of a wholly-owned foreign enterprise. Those European investors who join Chinese businesses will have one of the most important advantages: the local advantage. Usually, it is the foreign partner that brings the technology together with the capital and the Chinese counterpart searches for the appropriate site as well as being familiar with the local needs markets the joint venture's products and services in a more efficient way (Rugman et al., 2006, p. 591). Moreover, Chinese consumers would be more inclined to buy products that they believe to be of domestic origin and locally involved foreign entrants have a better chance to win domestic tenders. Correspondingly, equity joint ventures might receive the same treatment from foreign governments as domestic firms: fewer restrictions considering the repatriation of profits, reduction in taxes and advantageous loans. (Tayeb, 2000, p. 173)

However, the joint venture will only succeed if the Chinese partner has the knowledge to deal with unfavourable situations, for instance with red tape, therefore one should put a lot of emphasis on choosing the right Chinese counterpart (Rugman et al., 2006, p. 591). Further risks include the inability of the partners to understand each other's viewpoint as cultural and language barriers might hinder the decision-making process. In addition, foreign enterprises from developed economies are often less eager to pass over technological know-how especially when they cooperate with a company of developing country origin fearing that the partner enterprise will use the information against them thus becoming a competitor or as a result of the improper use of technology lower value products would be produced (Tayeb, 2000, p. 174).

The legal framework for foreign-invested partnerships was first introduced in 2010, so it is considered to be a newly formed, less known investment possibility for overseas companies. The Chinese regulation identifies three different types of partnerships: general, special general and limited liability partnerships. The general partnership imposes an absolute liability to all of the corporation's debts on each of the stockholders, which interpretation is further narrowed under the 'special general partnership' to professional companies, for instance accountant offices while the limited partnership demands the partner's liability proportionate with their contributed capital (State Administration for Industry and Commerce, 2010).

Compared to joint ventures forming a foreign-invested partnership enterprise (FIPE) takes less time because the number of procedures is significantly reduced. In the FIPE a minimum one partner is required to take absolute liability. Also, while in a joint venture only Chinese companies might be partners to foreign enterprises, in the case of FIPE, investors or foreign businessmen can enter into a partnership with a Chinese individual. In addition, this kind of foreign market entry enjoys corporate tax exemption as well as the authorities do not determine the value of the minimum registered capital (EU SME Centre, 2015, p. 27). Consequently, this form of investment might be appealing for companies in lack of resources, more specifically for small and newly created enterprises such as start-ups.

The primary goal of the People's Republic of China by providing this kind of investment option is to 'encourage foreign enterprises or individuals with advanced technologies and management experience to establish partnerships in China to boost the development of the modern service industry and other industries' (State Administration for Industry and Commerce, 2010). Therefore, European companies, individuals and academics that carry out research and development as well as provide high-tech services are warmly welcomed to form a partnership with a Chinese counterpart.

SME financing in China

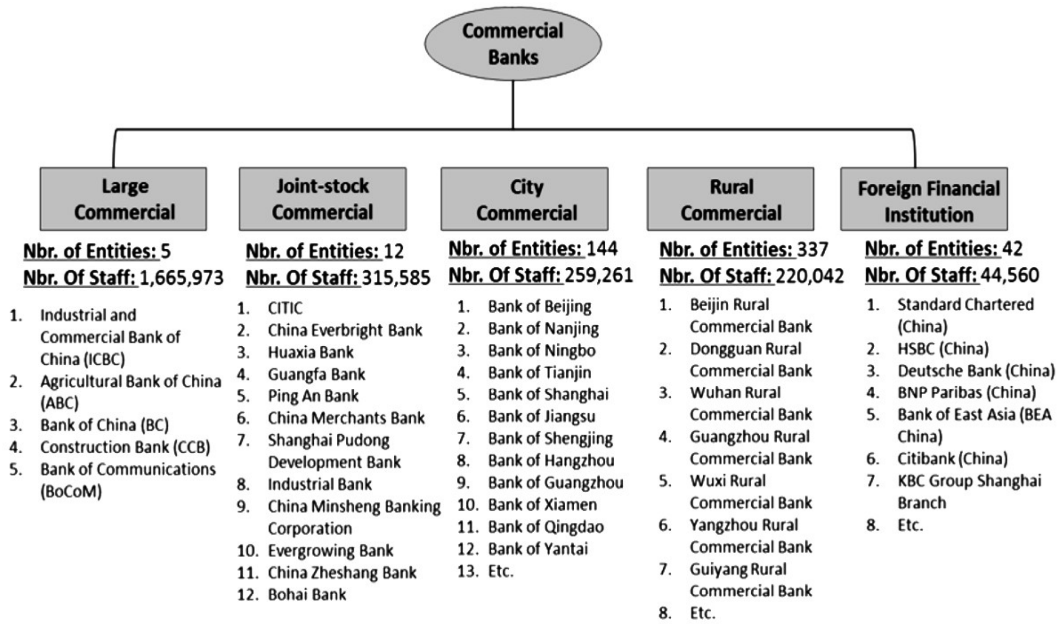
The majority of SMEs have a hard time in getting loans for their international operation as according to banks, investigating the SMEs' credibility is too costly. Even if there are promising start-ups, these financial agents do not want to take the risk due to the high failure rate of small businesses (Asian Development Bank Institute, 2015, p. 121). Besides being an SME, being a foreigner also makes it difficult to get the necessary financing in China. Even though Chinese banks are not supposed to distinguish between domestic and foreign enterprises, in practice they are more likely to provide loans for a Chinese SME than for a European counterpart as the former has a better understanding in the local practices (EU SME Centre, 2014, p. 4).

Generally, only a small portion of enterprise goes global in an international new venture form, thereby those, choosing the incremental way of market entry (in case of direct export) have to cope with the different costs arising from the internationalization, for instance, the cost of getting new buyers, evolving into networks as well as being compatible with the target country's standards. However, it is not easier for indirect exporters: they also have to satisfy the target country's need by adapting to the foreign buyer standards and they have to be punctual with regard to delivery (Asian Development Bank Institute, 2015, p. 121).

An SME might be funded either internally or externally. When the investment project of the enterprise is funded from the profit after tax or from writing off the depreciation internal financing takes place. External financing means that the company obtains the other part of the funds from the outside sources, through applying for bank loans or issuing stocks and bonds. External funds are divided into debt and equity financing. Companies under debt obligation borrow money only for a specified period of time, which they pay back at maturity. In equity financing in order to obtain funds for business activities the enterprise offers its ownership interest to investors. When a company offers its shares for the first time to Initial Public Offering (IPO) on the stock exchange happens. However, many SMEs are unable to be compatible with the strict rules of this kind of equity financing thus they either choose to raise funds from private equity (Peng, 2015, pp. 113-119.). In China, European small companies are not able or allowed to carry out an IPO whereas the Western private equity providers in China are more likely to grant this kind of service to European SMEs than Chinese SMEs (EU SME Centre, 2014, pp. 18-19.).

Various lenders might provide funds for SMEs namely credit institutions, leasing companies, suppliers but the most frequent lenders are commercial banks. In the People's Republic of China, all commercial banks use the Chinese approach to SME definition. The commercial banking sector in the Far-Eastern country can be categorized into 5 different groups. Except for large commercial banks, all of the commercial financial institutions provide services for European SMEs. Among the principal external financing intermediaries are joint-stock commercial and city commercial banks (EU SME Centre, 2014, p. 12).

Figure 2. Types of commercial banks in China



Source: EU SME Centre, 2014, p. 12

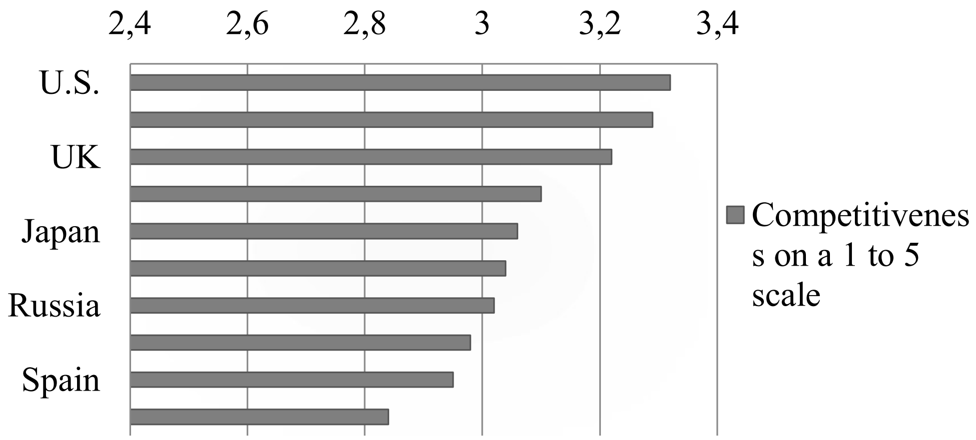
The Asian Development Bank declares a new phenomenon, the so-called supply chain financing, of high importance. In supply chain financing, the SME obtains the necessary loan because its business relationship with one or more multinationals serving as collateral. Multinationals are usually reliable borrowers in the eyes of banks thus all of their partners are eligible for a preferential treatment: smaller enterprises belonging to their supply chain networks can have a quicker access to payment (Asian Development Bank Institute, 2015, p. 122). In China, the primary providers of these financial services are joint-stock commercial banks (EU SME Centre, 2014, p. 10).

European investors in China

The European Union countries show different political views in relation to China (Fox et al., 2009, p. 4) that is also reflected in their inclination to invest in the Far-Eastern country. In the following, the exporting and investing activity of the three main exporters (Germany, Britain and France) in China will be examined with special regard to their SMEs.

The German SME sector is one of the strongest among nations in the field of internationalization. By contrast to Chinese counterparts, German SMEs are competitive in providing quality, offering services and meeting delivery deadlines rather than supplying with low prices (KfW, 2014, p. 1). According to a study published in 2014, China supplies the world market with more than 1480 different varieties of goods thus acquiring a leadership position, while Germany produces 700 and the US offers 600 ranges of products (Tichauer, 2015, p. 9).

Figure 3. International competitiveness of small and medium-sized enterprises



Source: KfW Competitiveness indicator (2014, p. 2)

The British small and medium-sized enterprises follow German counterparts in competitiveness; they take up nearly 80% of the British GDP while French SMEs are slightly ahead of developing economies. Contradictory to the expectations from China's economic growth, the Chinese SME sector underperforms in competitiveness (KfW, 2014, p. 3).

GERMAN SMES IN CHINA

The political and economic relations between Germany and China have always been characterized by mutual respect the friendly and cooperative attitude of German chancellors has contributed highly to German companies' choice of entering into the Chinese market (Tichauer, 2015, p. 3). Germany first considered the People's Republic of China as a preference country in 1993, in its launched German Asia Strategy. Eight years later in 2001, the strategy was developed into a policy, which outlined the importance of cooperation in economic, environmental, technological and human rights issues as well as its non-support for the secession of Taiwan from China. In the 90s, Germany was among the first economies that realized China's possible emergence into a world market so then the

European country set up trade and industry centres in Shanghai and in Beijing and further a chamber of commerce was opened in the latter city. It also pioneered in transferring its green technology so as to help China to cope with its environmental concerns (Wang, 2009, pp. 17-18.).

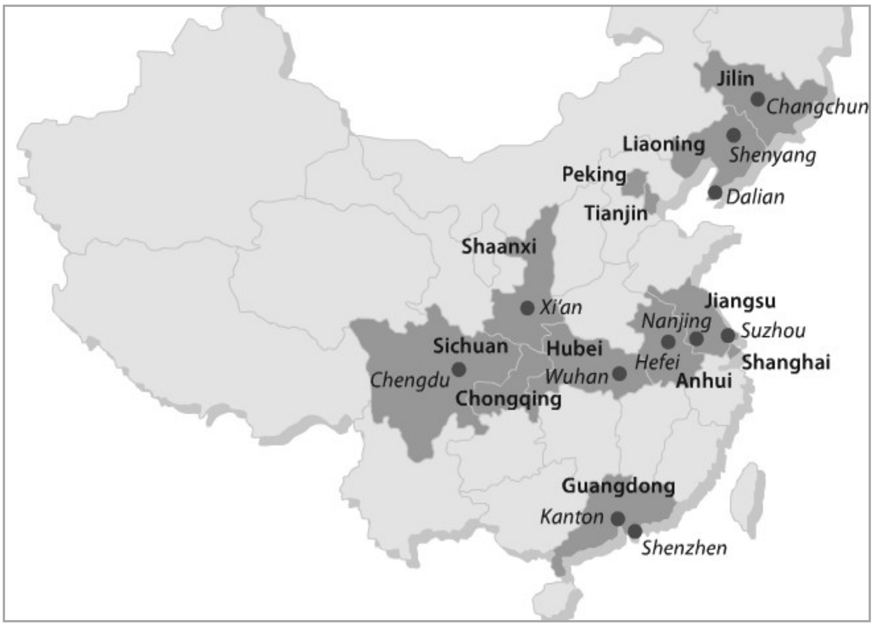
From the Chinese view point, the deepening of relations with a world leader country in the field of modernization and development was a means of gaining and maintaining a prominent place globally, as a result the German-Chinese bilateral partnership on innovation was concluded in 2015. On account of the Chinese liberal politics, small and medium-sized companies are continuous being established with German counterparts developing businesses (Tichauer, 2015, p. 3).

In 2014, China was Germany's greatest foreign partner in Asia also acquiring the third most important position among Germany's trading partners. The two countries' relationship has gone through considerable developments over the past two decades also by reason of China arising as a determining participant of the world economy. Moreover, German transactions with the Asian region between 1990 and 2014 increased fivefold due to the favourable progression of the Sino-German trade. Estimates suggest that more than 5.000 German companies have been engaging in promising Chinese investments, which also provide work for more than one million people. In their bilateral trade, Germany mainly exports vehicles to China and imports electronics while the second main product group, machinery, is sold and bought in approximately the same percentage (German Chamber of Commerce in China, 2015, p. 2).

Bringing production to China is becoming a high priority (particularly for German multinationals), but also nearly the same number of German businesses engage in the service industry as well as in marketing and sales activities. Enterprises in the field of research and development, procurement and trading are less concentrated in the Chinese market (German Chamber of Commerce in China, 2015, p. 19). However, the Germans are interested in establishing site development centres, so that they can deal with the investigation of new products locally. Owing to the innovative and digitized nature of German small and medium-sized companies, the sector is able to successfully open up to Chinese counterparts. In recent years, Chinese SMEs have also made significant efforts in research and development so as to meet demand, thus they exhibit themselves as potential competitors and partners for German SMEs. In 2015, the German Deutsche Telekom and the Chinese Huawei collaborated in the scope of a common technological project and together provided information and communication technology solutions for SMEs. In the recent years, China's demand for food products has been continuously accelerating (resulting in a growing number of imports), evolving into the largest food market in the world – thus the popularity of the German food sector is increasing, too. An important reason for this enlargement can be explained by the growth in the income of the urban population who put more emphasis on being health-consciousness, so creating a need for western food. In addition, due to China's food scandals the Chinese consumers have lost confidence in domestic products as a consequence they substitute them with e.g. the German food products. However, exporting German SMEs still experience barriers because of the existing cultural differences, local competition, legal obstacles and distribution hurdles. The underlying opportunities in the field of the pharmaceutical industry, healthcare and elderly care might also be a good reason for deepening German-Chinese cooperation as China's demand to satisfy this need is constantly growing – the successful German health care sector of hundred year of experience might be competitive in this aspect (Tichauer, 2015, p. 16).

It was reported that more than two third of German companies enter the Chinese market in a wholly owned foreign enterprise form, while the remaining one third chooses joint ventures, holdings and office representation. Typically, internationalizing companies conduct their operations in several locations taking advantage of opportunities offered by special economic regions. The German presence is highest in Shanghai, followed by other popular destinations like Beijing, Hong Kong, Singapore, Shenzhen and Guangzhou (German Chamber of Commerce in China, 2015, pp. 17-18.). The reason why German enterprises can be found in the Bohai, Yangtze and Pearl River Delta regions is that the infrastructure is modern and production costs are low making them attractive to German companies (Tichauer, 2015, p. 24).

Figure 4. Locations with strong German engagement



Source: Tichauer, 2015, p. 60

Among the main problems and operational market barriers are finding qualified employees, high labour costs, retaining the skillful staff, the Chinese yuan exchange rate, administrative obstacles, the underdevelopment of the internet technology, the protectionist measures of the Chinese government, legal complexities and the violation of property rights. Since China's WTO accession, German companies' situation has been positively affected, (proven by the improvement in figures for 2015) they better adapted these challenges than in the previous year, although this process of progression remains slow (German Chamber of Commerce in China, 2015, p. 12). For the present, German enterprises do not perceive hardships caused by the sluggish growth of the Chinese economy (Tichauer, 2015, p.3).

In 2008, the average time needed for Chinese market entrants in the service sector was two years while in the production sector they balanced after four years. Among the surveyed enterprises, which located themselves in China there was no substantial re-export activity, but rather a strong focus on satisfying local needs. Also, huge changes have taken place in the number of SMEs between 1998 and 2004 meaning that their share in all German companies in China has grown from 20% to more than 50%. Moreover, their scope of activities has also changed, namely from heavy industry export they have shifted towards the increased demanded service sector (e.g. consultancy, logistics and trade organization) (China Daily, 2008).

FRENCH SMES IN CHINA

The French and Chinese view on international affairs is very similar as both countries promote the idea of independence of nations and world diversity. Unlike Germany, France advocated Taiwan's efforts of breaking up with Mainland China by supplying Taiwan with weapons. As a consequence, the French-Chinese relations faltered and the question of arms sales is still on the agenda. However, after 1993 the diplomatic relations were strengthened again and the French proclaimed their interest in developing a long-term bilateral partnership with China (Wang, 2009, pp. 15-16.).

French SMEs have been investing heavily in China since 2001, because the Far-Eastern country's accession to the WTO has contributed a lot to the facilitation of investiture. The primary condition of entering the Chinese market is to establish joint enterprises with the Chinese counterparts, as abolished and the wholly owned foreign enterprise form became accepted, favoring the development of not only large enterprises but small enterprises as well. The number of French SMEs investing in China is very low (in 2011, it was estimated around 1800) and the upper value of their FDI account for only tens of millions of euros – still it is considered to be a noteworthy result as investing in China requires a substantial effort. Despite the difficult market entry and restrictive legislation many French SMEs are successful in China (Derez et al., 2011, pp. 6-11.).

France, taking the advantage arising from political cooperation is pushing its investments to China by supporting its companies while primarily focusing on the conclusion of large contracts (Casarini, 2006, p. 17). Recently, the French Chamber of Commerce in Shanghai realized that the links between French companies abroad are not as developed as between enterprises of countries like Germany, the United States or Japan. Despite the fact that the French presence in China still heavily persists and there are a vast number of French actors in China, the number of trade negotiations between French multinationals and SMEs is not sufficient, in other words France lacks a cohesive business community in the Far-Eastern country. Consequently, the 'Working Together Forum' has been organised since 2009 (the first forum held in Beijing) to boost the French economy abroad. The purpose of this forum is thus to increase the collectiveness of French companies, to strengthen relations and take advantage of their complementarities and synergies (Thibaud, 2014).

The French Chamber Commerce and Industry's survey suggest that French companies raised their revenues mainly b providing services and combining service and retail activities (CCIFC, 2015, pp. 9-19.): the services accounted for almost three quarters of the settlements (Derez et al., 2011, p. 9). At the same time, China's economy is characterized by a share of 48.4% of industry (Central Intelligence Agency, 2016). The opportunities offered by the growing Chinese market therefore remain linked to industrial orders.

More than 35% of the interviewed companies have been present in China for 6-10 years and one quarter of the enterprises have been doing business in Mainland China for 11-20 years. Consequently, the French presence is featured by long-term commitment in the Chinese market. French SMEs are principal members of the Chinese Department of the Chamber with a share of 70%. The main risks members indicated were increasing labor costs, lack of professional staff, sluggish growth and foreign exchange volatility. The strength of French companies in China lies in the following: innovation, quality and well-designed products, recognized brands, efficient operations, management expertise and improved customer service (CCIFC, 2015, pp. 9-19.).

Shanghai is a popular first destination of French SMEs because they can profit from the already existing French network of companies, the maturity of the city's economy and the availability of a skilled workforce. Most of the companies do not move to Western provinces, which are less costly than a large city because they are compensated by these benefits. However, the production costs are increasing as well as Shanghai's market is saturated compared to inland provinces (Derez et al., 2011, p. 12).

Challenges coming from the part of Chinese competitors were also investigated and it turned out that competitive pricing, locally created brands and services offered by Chinese counterparts might impose a threat to internationalizing French companies (CCIFC, 2015, pp. 9-19.). For France, the most important European competitor in the Chinese market is Germany. Although both countries have similar strategies Germany's better position is reflected by the volume of exports. Between the period of 1995 and 2010, the French FDI to China was only 60% of Germany's FDI. The government of France has tried to consolidate the French SMEs' presence in China following the example of Germany, which has already opened centers in Shanghai and Beijing (Derez et al, 2011, p. 10). Also, a programme carried out by the French Embassy since 2008, 'COPOOL' has aimed to help the matchmaking process of French and Chinese innovative SMEs as well as enhance competitive clusters (European Union, 2014, p. 25).

BRITISH SMES IN CHINA

The United Kingdom (UK) just like Germany and France also concludes great deals with China. Contrary to the other two European countries, which put a lot of effort in reducing their trade deficit with the Far-Eastern country, the UK is not so efficient in protecting its industry against the Chinese inflow of products. The European country with one of the largest trade imbalances with China rather promotes UK-based enterprises than taking restrictive measures against the Chinese imports (Casarini, 2006, p. 18).

In 2013, Sino-British SME cooperation was signed between the China-Britain Business Council and China's SME organisation for the UK, which established a mutual non-financial support for British and Chinese SMEs to enhance UK-China bilateral trade. Both partners agreed on the achievement of innovative growth of the economy as well as on the creation of jobs. The Trade and Development Department of the UK Government also expressed agreement on the promotion of small and medium-sized enterprises. They reasoned the need for the three-year support by the statement that the situation of internationalizing SMEs is not easy either in Europe or in China. The project was extended to cover areas like advanced manufacturing, the food sector, financial services, green technologies, healthcare, etc. (China Daily, 2013).

The recent study of Western Union Business Solutions including one thousand British SMEs, which are already conducting international transactions, came to the conclusion that in general UK companies count towards a positive outlook regarding China's future growth. Moreover, from the export point of view, China is a more popular destination than any other BRIC countries (India, Brazil and Russia) and the engagement with developing economies is recognized as an area of great growth potential, but still the markets of other Member States remain the dominant export targets. The biggest difficulties that British SMEs associate with internationalization were reported to be: deferred payment, cash flow problems, getting credit and foreign exchange volatility (Pozzi, 2014). Furthermore, in China the bureaucratic system, insufficient interpretation of laws, corruption and protectionist measures of the Chinese government were reported to be the main challenges for UK companies. British enterprises perceive reduced risks associated with the violation of property rights as well as they are much better prepared to defend their rights. In the survey of CBBC et al. (2013) the majority of UK companies classified China among the three most important world markets. In addition, nearly half of the British companies state that their primary goal to operate in China is to serve the Chinese consumers. Generally, they do not consider Chinese businesses as their greatest rivals, but rather other internationalizing enterprises of Western developed nations (i.e. the US and EU countries) (CBBC et al., 2013, p. 7).

In the period between 2010 and 2014, the British companies' export to China increased twofold, accounting for GBP 14 billion. Accordingly, after Germany, the United Kingdom comes in selling the greatest volume of commodities (vehicles dominate) and services to China. While Germany exploits benefits from providing healthcare services for China's ageing population, the British have competence for offering insurance services to the same group of people. Therefore, as loosening of market entry requirements for foreign financial institutions took place in 2013 the potential is there for British companies to penetrate the Chinese markets by ‘insuring China’s huge, uninsured population’ (The UK Government, 2016).

The China-Britain Business Council also confirms that the Chinese quality of life is improving: consumers are more likely to afford imported quality products as a consequence this opportunity can be fully exploited by British companies. For UK SMEs, one suggested doing E-commerce activities because this way, enterprises might assess the demand from the Chinese market thus ignoring high risks. On the other hand, the Chinese government recently realized that the imported goods are sold at a lower price than those ones in Chinese stores so planned to introduce reforms in the taxation. Nevertheless, this step was not taken immediately and the decision on the issue was postponed for one year. It is important to mention that the Chinese government's aim primarily was to enhance the safety of consumers and did not directly apply to the exclusion of foreign products (CBBC, 2016). The UK Government (2016) again recommends an industry in which it might worth for British SMEs to operate, namely the marine sector. China, being the most competitive nation in this field is further increasing its spending in vessel-building so its need for special marine-related services and supplies has become greater, creating opportunities for UK SMEs.

Summary

As the research has revealed the market entry for the internationalizing players of the EU SME sector is quite restricted, which can give explanation to the relatively small number of SMEs expanding to China. Despite China's membership in the WTO that entails liberalization, the EU still doubts China's capability of functioning in compliance with market economy standards as European investors often face limitations regarding investments and access to national tenders. By contrast, risks identified by SMEs of Member States concentrate on e.g. higher costs of labour, difficulty to find workforce and greater competition coming from domestic-based companies – all these are explained by China’s better position in the world: it is less likely to show a developing economic nature due to the phenomenon of the rising of its middle class. Still, opportunities deriving from China's huge consumer base might be exploited by European enterprises. The findings on the specific company formation possibilities have proven that European SMEs need to adapt the challenging business environment and either should manage their operations in market niche industries that are positively regarded by the Chinese government. Finally, it can be concluded that the three most dominant EU partners to China try to learn from each other's examples on promoting SME internationalization to China therefore becoming potential competitors to one another.

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THE RATIONALE BEHIND ANTI-EU VIEWS: THE CASE OF HUNGARY

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The decline of the West is a very old topic in social sciences. The idea was very popular in the early 20th century; and yet again, Europe has been recently featured as a declining region that is expected to lose economic and political importance in the decades to come.

Originally, Oscar Spengler's successful book – first published in 1918, receiving a Europe-wide attention – popularized the concept of 'the decline of the West'. Nationalist and extremist political movements used Spengler's arguments, which followed a biological model of growth and decline, emphasizing the ineluctable collapse of the Western civilization.

This gloomy view is followed by many even today; so not only historians of the past but politicians of the present have also emphasized the fragile state of the European project, in many cases predicting the break-up of the EU. Brexit appears to be a clear evidence for the spread of this approach; however, the British have always been a reluctant European partner. (This is why the outcome of the election in June 2016 might have surprised the elite, although the rejection of the European project has a very strong tradition in the English political culture.)

In the literature, the phrase 'reluctant partner' has been used to describe the ambiguous British attitude towards the European Union. After Brexit, the Central Europeans[49] will be labelled as the reluctant partners in the EU. Their reluctance to go further in the European integration project has come as a shock to the EU-governing elite and the core countries of the EU (Germany, France, Benelux-countries). It was surprising to them since

[49] In this analysis, Central Europe refers to new member-states of the EU; the Visegrad-Four countries, the Baltic-countries, Romania, Bulgaria and Croatia. Russia and other Post-Soviet states (with the exception of the Baltic countries) are different in many ways; therefore, these countries are not taken into consideration in the analysis.

those Central European countries, who became member states of the EU only in 2004 have received significant EU aid for over more than a decade. Despite these clear financial benefits, dissatisfaction with the EU among these countries grew significantly after 2008. As mentioned above, being discontent with the EU might be shocking, but it is more understandable if the same issue is considered in terms of national sovereignty. The newly-won political freedom after the collapse of communism has a very strong value to Central Europeans. At the same time, the very countries are supposed to relinquish different parts of this new freedom in an "ever closer Union", where further integration seems to be an evitable answer to the problems of the EU. This contradiction between clear economic benefits and heavy political losses is hardly to be reconciled.

To add to this political tension and ideological chaos, not only nationalist and anti-EU, anti-globalization forces call for some reforms or even the break-up of the EU, but liberal and/or left-wing economists see a need for change as well. Alberto Alesina and Francesco Giavazzi f. ex call for reforms in their book 'The Future of Europa. Reform or Decline'. The authors conclude that Europe's economic struggles can be traced back to the inadequate regulation of the economy. Their solution involves the deregulation of markets, the liberalization of labor markets, promoting policies aimed at reducing debt and protectionism. This assessment is lopsided, since bad performance does not characterize all the European countries (Scandinavian countries, Germany, Austria), but there are large economies in Europe (France, Italy) which have not been so successful in tackling the issues of globalization.

The solutions proposed by Alesia and Giavazzi clearly differ from those of nationalists and anti-globalist movements; however, all political factions and movements are discontent with the European Union to some extent. The recipes range from strengthening nation states, dismantling the liberal post-world war order to integrating Europe further, and establishing the United States of Europe. Despite having managed all former crises effectively, despite being one of the most important economic powers in the world, it is clear the EU is on the threshold of a new world.[50]

This paper hypothesizes that the Central European anti-EU and anti-globalization voices and sentiments in Central Europe are to be explained by distinctive reginal characteristics which can be traced back to a divergent historic development of the region. After briefly (1) summarizing the most important features of Western European achievements, (2) the differences with Central Europe, and (3) reviewing the theories of European integration, an attempt will be made to explain why the historic approach provides a better understanding of not only the Central European region, but of the entire European Union.

The diversity of the European continent

Although, in comparison to other parts of the world, Western and Central Europe together form a more or less coherent region in political, economic and cultural terms, Europe has never been unified, it has never been under the control and governance of a centralized political power. There have been several attempts to centralize Europe, but neither the Romans, nor the Caroling Empire, the Nazis, the Soviet Union could extend its power to the entire continent. As a consequence of diversification or fragmentation of the continent, wars had characterized the history of Europe throughout the centuries, but there is another side of the internal competition, it led to great accomplishments in technology, economy and politics. Niall Ferguson in his book „Civilization. The West and the Rest" writes of this puzzle of the history: "For some reason, beginning in the late fifteenth century, the little states of Western Europe with their bastardized linguistic borrowings from Latin (and a little Greek), their religion derived from the teachings of a Jew from Nazareth and their intellectual debts to Oriental mathematics, astronomy and technology produced a civilization capable not only conquering the great Oriental empires and subjugating Africa, the Americas and Australasia, but also

[50] In 2015, roughly seven percent of the world's population living in the European Union produced 22.1 percent of the world's GDP in current prices. On the other hand, however, Europe's contribution to world GDP is declining because of its shrinking share in world population and intensifying competitiveness issues.

converting peoples all over the world to the Western way of life – a conversion achieved ultimately more by the word than by the sword. … In 1500 the future imperial powers of Europe accounted for about 10 per cent of the world's land surface and at most 16 per cent of its population. By 1913, eleven Western empires controlled nearly three-fifths of all territory and population and more than three-quarters (a staggering 79 per cent) of global economic output" (Ferguson, 2011, p. 18.).

This internal competition was one of the reasons why European countries contributed so much to the development of new technologies, solutions, ideas, etc. As the experiences of other regions in the world indicate, this side of the competition is an important element of European dominance over the last five centuries, since inward-looking policies and disregard for technological innovations always lead to economic backwardness and (asymmetric) dependence. As European countries remained one of the core regions of economic development, they were all part of an economic division of labor in which resources, ideas, skilled labor and capital were allowed to flow between the countries freely. That means despite fragmentation, a certain degree of integration remained among these countries allowing for competition.

After WW2, Western European countries – not least because of the deepening Cold War – reshaped their democracies, established a new kind of capitalism and laid down the foundations for successful future regional integration, the birth of the European Union. Over the decades after the WW2, Central European cut the economic and political ties binding them Western Europe. The failure to catch up with the West, made the Central European dependency on Western European capital and technology clear. After the unsuccessful experiment with communism, Central Europe joined the European project, there ares still clear differences between these two part of Europe. What are the reasons behind the differences in economic success? Is it simply the consequence of the unfavorable integration into the international division of labor or should other factors also be taken into consideration?

French philosopher Montesquieu was the first intellectual who tried to explain the permanent prevalence of income differences between countries. He pointed out that climatic difference between the regions plays a crucial role. It is obvious that such an explanation cannot be applied to the case of Central Europe. A modern version of this explanation stems from Jared Diamond who – in reference to the failure of China after 1500 – highlights the importance of internal competition within Europe too (Diamond, 1999, pp. 322-333.). From a different perspective Bronk and Jacoby emphasize the merit of diversification as well when they state that "Analytical and regulatory monocultures may be prone to disastrous blindness to emerging problems if hit by unforeseen disasters. Moreover, in any policy area characterized by innovation and uncertainty, there are greater benefits from policy diversification across the Union than the standard analysis of the benefits of coordination around common policies would suggest" (Bronk-Jacoby, 2013, pp. 33-34.).

From a historical perspective Acemoglu and Robinson attribute the successes of the West to pluralistic political and inclusive economic institutions. They argue that the way institutions within society are organized is decisive in determining the outcome, the productivity of the economy and the well-being of citizens. "Inclusive economic institutions that enforce property rights, create a level playing field, and encourage investments in new technologies and skills are more conducive to economic growth than extractive economic institutions … Inclusive economic institutions are in turn supported by, and support, inclusive political institutions, that is, those that distribute political power widely in a pluralistic manner and are able to achieve some amount of political centralization so as to establish law and order, the foundations of secure property rights, and an inclusive market economy" (Acemoglu- Robinson, 2012, p. 56.).

Based on these explanations it is assumed that the connection between political and economic institutions may be a crucial element in explaining Central Europe's long term economic backwardness. Both Acemoglu-Robinson and Fukuyama argue the political institutions dominate the relationship between economic and political institutions. The success of a political order can be measured by different indicators, however, theoretically, there are five important elements which matter in the long run:

1. the rule of law;
2. rapid economic growth;
3. democratic institutions;
4. a competent and efficient state bureaucracy; and
5. a vibrant, strong civil society.

Levy and Fukuyama (2001 p. 3) compiled this list of components that are crucial to implementing a successful development strategy. There is a broad consensus on the essential elements of a successful political order, however there is disagreement over whether sequencing among these elements matters or not. While Mansfield and Snyder are cautious about democratization without having an efficient (impartial), relatively competent state-mechanism, Carothers and Berman doubt whether getting the sequence just right (first state-building before holding elections) is necessary to reduce the risk of violence during the transition (Carothers, 2007, pp. 17-27; Berman, 2007, pp. 14-47.). Along with Fukuyama, they argue that, aside from the East-Asian examples, it is difficult—almost impossible—to break the self-reinforcing cycle between autocratic political institutions and extractive economic institutions exploiting most of the population. Fukuyama puts:

"The problem, as Carothers points out, is that the number of cases where one can find genuine development-minded autocrats is extremely small. Carothers is also right that outside powers greatly overestimate their influence if they think that they can somehow determine the sequencing of reforms. I would simply add that virtually all the real cases of this kind of sequencing have occurred in East Asia, where Japan, South Korea, Taiwan, and Thailand (at least until the September 2006 military coup in Bangkok) have made democratic transitions, and where authoritarian governments in China and Singapore have built impressive economic growth records. It is no accident that these cases are grouped in East Asia. Many countries in that region had long traditions of strong states with merit-based bureaucracies well before they began modernizing" (Fukuyama, 2007, p. 10).

Based on the idea of sequencing, the crucial question which remains is: what are the possible scenarios countries may face in their development? Fukuyama delineates three basic models, from which the Italian and Greek sequencing is most akin to the Central European development path.

1. In the Prussian/German sequencing, the first step was to build an efficient state (step 1), which required bureaucrats who could rely on rules, and thus implementation of a system based on the rule of law followed (step 2). The two elements prepared the stage for an economic take-off (step 3) around the end of 19th century. This might explain why in this example the state has had a much larger role in economic development than in England. In the decades of economic boom, a new social class—that of the workers—was emerging (step 4), demanding more participation in the political system (step 5). As we know, it was only after WWII that liberal democratic institutions could be stabilized in Germany.

2. The American society took a different path since the first element was rule of law (step 1), which along with early democratization of the country (step 2) laid the foundation for fast economic growth (step 3). Economic growth created strong social mobilization (step 4), which supported state-building (step 4). As we can see, state-building, and establishment of an efficient bureaucracy which was the first stage in Prussia, came last in the United States.

3. At the same time, Fukuyama demonstrates that, in the cases of Greece and Italy, social mobilization and democratization

> preceded state-building and economic growth. If rule of law is not implemented properly, this sequencing is detrimental to stability, (Fukuyama, 2014, pp. 198-216). Both Greece and the Central European countries share the common experience, that freedom and independence were not fought by them but given to them by chance or external forces. In other words, the rule of law and the efficient state did not precede democratization and social mobilization of these societies.

Different sequencing of elements of the political system in Western and Central Europe led to widely diverging paths. The competition among Western European countries could be complemented with the tradition of free market economy and democracy, while many of the Central European countries are still not mature democracies and the market does not work properly partly.

After 1990, diverging paths of Central and West Europe seemed to converge again, however, despite the deep economic and political transformation after 1990, some of these Central European countries have, in recent years, began to turn away from the Western European model. Examples include Hungary, Romania, and the Slovak Republic. In several Central European countries, the measures implemented by the governments after 2008 testify of a shift to the (re)establishment of a state-led capitalist model and of the emergence of a new state model (the "illiberal" state).

In a broader view, it is also important to underline that "The state of freedom declined for the eighth consecutive year in 2013" (Freedom in the World 2014, p. 5) which suggests that the spread of democratic values and the flourishing of pluralistic societies is not an automatic process in which democratic societies cannot fail, and similarly that the democratic and free market economy model is not something undemocratic societies will inevitably resort to.

The puzzle of Central Europe

Central European countries have lagged behind the West in the past centuries although several attempts have been made to close the gap between the two parts of Europe. These countries performed poorly in the past compared to the more advanced regions. The most notable one of the concepts to explain this puzzle of Central Europa is that of the two Europe explanation marked by the name of Leopold von Ranke, who stressed the importance of delayed development, which – in his opinion – had been caused by the late state- and nation building processes in this region. There are also other new and important insights provided by other researchers from an historical perspective.[51]

The state- and nation-building process took off much later in Central Europe than in West Europe. The paradox which most European countries now face stems from circumstances shaped by globalization, since globalization and the need for regional economic integration would logically push these countries forward on the road to closer integration, but most of the European nation states that emerged in the last two centuries resist further integration, mostly because national identity had been forged by the nation- and state-building process of the 19th and 20th century. The concepts of "national identity" and "nation state" cannot be separated from each other in Europe in most of the cases. This fact has two consequences: first, some of the European nations (especially the small ones of Central Europe) are reluctant to go further into regional integration. Secondly, when analyzing the EU, we have to accept the existence of different political and economic regimes in the long run. There is no linear convergence of Central Europe to Western Europe, moreover, in different epochs, convergence can be reversed and the need for decoupling from the West becomes stronger.

After 1990 there was clear optimism regarding the future of the region. Fukuyama's famous phrase "the end of history" characterized the sentiment of the decade precisely and reflected a kind of "Zeitgeist". In full agreement with the main thoughts of Fukuyama that democracy and the

[51] Berend (2011) provides a comprehensive literature review on the topic.

market economy are the most effective tools to create successful societies, it can be argued that the lack of inclusive democracy and market failures have been preventing this region or at least parts of it from becoming real success stories. Before 2004, there was no disagreement on the economic and political benefits of the European project in these countries. Although in terms of EU-funds, every new member country benefited from EU-membership, the signs of public disappointment had been palpable in some of the new countries already before 2008. Yet the real disillusion came in 2008, when the financial crisis struck the world economy and hopes of rapid convergence with the West had vanished. Moreover, in some of the countries, problems of external financing led to a new wave of economic crises in Central Europe.[52]

Not surprisingly some of the countries had problems finding appropriate answers because the dispute was now not only about the globalization or the European integration, but also about the ways European nation states could survive in the 21st century after the great global restructuring in the past two or three decades burdened by the consequences of the crisis of 2008. It is most certainly a broader and more complex problem than that of Central Europe.

We don't know yet, whether the revival of geopolitics will "undo the post-Cold War settlement and the US-led global order that stands behind it…" (Mead, 2014, pp. 69-79.). But it is certain that many Central European politicians (within and outside the EU) have already begun questioning the liberal order of post-1990 and this change in the attitude may have far-reaching and damaging consequences for the European integration. Although it must be noted there is a clear difference between former Soviet countries,[53] where immediately after 1990 democratization was blocked, and the other Central European countries, where a comprehensive democratization process was allowed to take place, and they became members of the EU. It is important to highlight that the former group of

[52] The picture, however, we can get of the region is more complex. There have been visible fault lines within the Central-European region itself with regard to EU-policy and the appropriate economic policies. The reasons for their better or poorer performance are different. (See Novak 2014 in detail. Novak 2014: pp.3-10.)
[53] With the exception of the Baltic countries.

countries has, in fact, never been democratized. But in recent years some countries of the second group have also questioned the benefits attainable via this road.

Theories of the European Integration

When it comes to the theories of the European integration, there is a clear theoretical dilemma. Is the European integration a separate, unique political and economic process, which has little to do with other models of economic and political integration? Verdun describes the dilemma the following way: "The European approach has been increasingly moving away from general theories and has been more inward focusing, thereby only seeing the case of Europe as the one that is interesting to study because of its inherent characteristics. … The American approach by contrast has been moving toward less case specificity in favor of contributing to the more general literature in political science" (Verdun, 2003, p. 96.). If the answer is no, we have to turn to more general theories which may explain the problems of Central Europe in a more accurate way because current theories of European integration fail to provide the reasons for the struggles of these countries.

An additional theoretical problem is that concepts of the European integration often rely on either economic or political approaches and the various political and economic regimes are not considered. This necessarily leads to misunderstanding of the processes, which is particularly apparent within the concepts of integration. The three main theories of European integration are neo-functionalism, federalism and inter-governmentalism. Neo-functionalism places emphasis on automatic spill-over effects which were generated by the economic integration and led to further integration of other areas. Nevertheless, the theory was only able to explain the integration processes of the 1960s accurately. Sandholtz–Sweet claimed "By the early 1990s neofunctionalism was virtually extinct. In the common narrative, De Gaulle's empty chair, the Luxembourg compromise, and the failure of ambitious integration plans in the early 1970s refuted the Neo-functionalist expectation that integration would be a relatively steady process, in which market integration would and the building of policy-making competence at the EU level would go hand-in-hand" (Sandholtz-Stone Sweet, 2010, p. 3.).

In 2014, it is needless to say that neo-functionalism is not sufficient to explain the changes taking place in the economic policies of some of the Central European countries or reforms of the economic governance in Europe. But this approach is still enormously important in explaining the economic benefits of the integration and references should be made to it when analyzing CEE. In many cases, inter-governmentalism and neo-functionalism are described as two very different and divergent theories of the European integration. But they can also be interpreted as theories which are only capable of explaining either the dynamic or the static side of the European integration.

Without a shadow of a doubt, inter-governmentalism was more accurate in explaining the processes and the political climate of the 1990s when major reforms could take place as a result of agreements made between the European governments. (Maastricht Treaty, the Nice Treaty, Lisbon Treaty, etc.) But the theory failed to clarify and highlight the economic benefits and the final goal of the European integration. Although federalism is able to provide a definite answer regarding the goal of integration – the "United States of Europa – USE" –, it fails to find a feasible way of achieving it. And given the political environment in Europe, the proponents of the theory are highly unlikely to achieve this goal unless they can plausibly respond to challenges posed by nationalist movements and other EU-skeptical forces.

Up to this point, we only discussed theories, which attempt to give a rationale to the existence and functioning of the EU, however, there are other types of concepts which focus on the diversities of the EU. There are subtle, but noticeable differences between them, but all of them refer to the diversity of Europe. A better understanding of the state of Europe as we know it today requires a more complex approach. Both sets of explanations focus on the diversity of Europe, this is the most important feature they have in common, but there are other factors that also need to be taken into consideration.

The “two- or multi- speed Europe” is used to refer to the fact that some of the member states are delayed in the integration process while other countries cooperate at an earlier point in time. The concept is often referred as a temporal one.

1. In the concepts of “Europe of concentric circles” or “core Europe”, emphasis is placed on the creation of a federal union with only a few members. In this approach differences are not temporal and the spatial nature of the integration is underlined because only core countries are in a position to make decisions concerning the political union.
2. The conceptualization “Europe a la carte” is a theoretical approach in which the sectoral differentiation is put in the limelight.

However, sectoral, temporal, and spatial aspects are not sufficient to describe the diversity of the EU. There are of course other suggestions of completion of this concept too. Transcending Alexander Stubb's three way classification (temporal-spatial-sectoral), Holzinger-Schimmelfing suggest that this concept should ”be distinguished along six dimensions: (1) permanent v. temporary differentiation; (2) territorial v. purely functional differentiation; (3) differentiation across nation states v. multi-level differentiation; (4) differentiation takes place within the EU treaties v. outside the EU treaties; (5) decision-making at EU level v. at regime level; (6) only for member states v. also for non-member states/areas outside the EU territory” (Holzinger-Schimmelfennig, 2012, pp. 296-297.).

It must be added, diversity of the EU is a valuable asset. Revealing the importance of diversity to the EU, Bronk-Jacoby argue in support of avoiding “monocropping” in the European Union: “In a nutshell, we argue that in a world of uncertainty we cannot know what the best model or best practice is or will be, and that this raises the insurance value of diversity of theoretical framework and practical regulation” (Bronk-Jacoby, 2013, p. 6.). Agreeing entirely with the idea that diversity gives the European Union long term advantages, it should also be clarified however which political and economic regimes can be considered acceptable in the European Union.

Concluding Remarks

Although, along with these six dimensions we may explain some of the temporal and constant peculiarities of the European integration, but we cannot explain how and why these peculiarities emerged and continue to prevail in Central Europe. An institutions-centered approach to political economy can be confirmed by Niall Fergusson's concept and that of Acemoglus and Robinson too.

1. Historian Fergusson believes the successes of Western Europe lie in the following "killer apps": competition, scientific revolution, property rights, modern medicine, consumer society and work ethic. Fergusson's approach might explain the large differences in political and economic differences to be found around the world, but these analytical tools are less appropriate to give a rationale to subtle differences among European countries.

2. While pointing out similar features, Achemoglu and Robinson go further and make a successful attempt in finding the reasons why several societies are better at creating prosperous economies. They have identified a strong correlation between the country's economic and political institutions and its failure or success as a society. In Western societies, pluralistic political institutions and inclusive economic institutions reinforce each other, creating a positive circle; while in less successful societies, exclusive economic and absolutist political institutions create a self-reinforcing vicious circle. The insights of Achemoglu-Robinson highlight the importance of institutions and that of the different political and economic regimes, however, they don't explain how these differences emerges among European countries.

As a consequence, explanations can only be offered on country-basis, thus in the following we take a short glance at the Hungarian development path, using the terminology of Fukuyama, which emphasizes the relevance of sequencing in the development of the political system. He argues that the rule of law, the competent state, fast economic growth, social mobilization of broad masses, and democratic institutions are crucial in establishing a successful political system, but at the same time he states that the sequencing of these elements also matters. As mentioned before, he delineated three basic cases, in which different sequencing led to dissimilar outcomes. The case of Germany and Japan showed a path in which democratization was the last element, while in the US and in the United Kingdom, efficient state and bureaucracy were the last panels. In contrast to these ultimately successful models, Greece and Italy were mentioned as countries which despite being democratic, failed to establish institutions based on the rule of law, and where rapid economic growth was also of a temporary nature, reduced to a few decades.

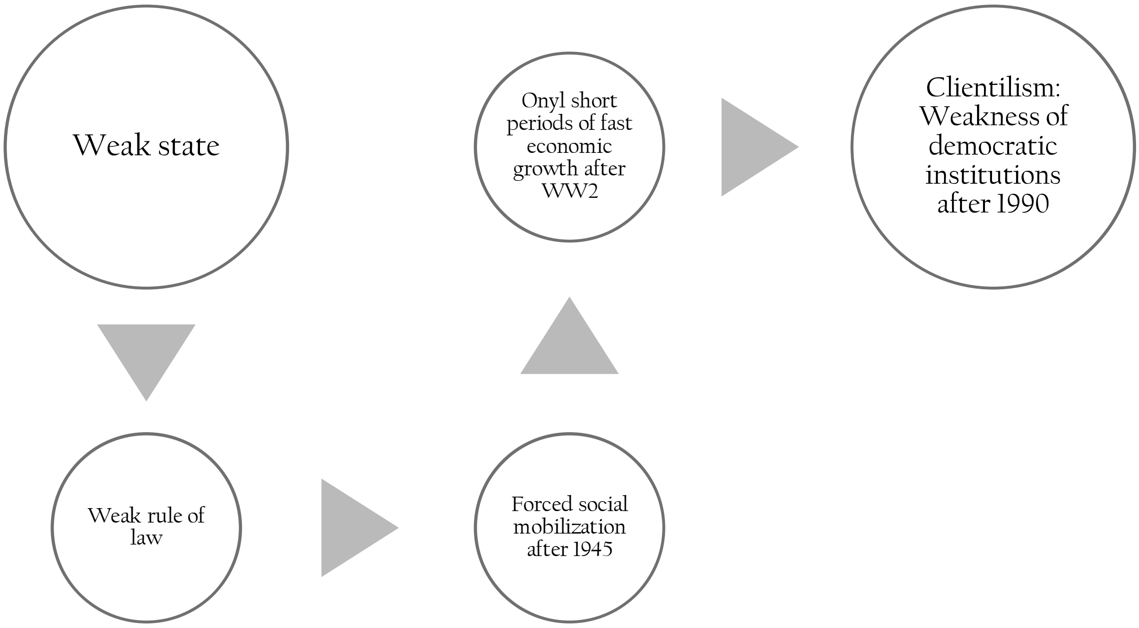
Hungary belongs to those countries where state-building took place at a very early stage. In contrast to many Central European countries, the Hungarian statehood, along with the Polish one, can be traced to the 10th and 11th century. Despite the relatively early state creation, efficient bureaucracy – one that is based on merits of the bureaucrats and not on kinship or political connections – never emerged in Hungary. The absence of a competent state encouraged the spread of clientelistic practices, leading to high-level corruption which became a fixed feature of the state's functioning.

However, it is a widely-spread delusion that clientelism would stand in sharp contradiction with democracy. Fukuyama emphasizes in the case of the US as well, that the early stage of the democratization process could be featured as clientelistic. He puts: "… The fact that this happened in the United States, the first country to experiment with an expanded democratic franchise, suggests that the ensuing clientelism should not be regarded as an aberration or deviation from "normal" democratic practice, but rather as a natural outgrowth of newly implanted democracy in a relatively underdeveloped country. No country, the United States included, ever leaps to a modern political system in a single bound" (Fukuyama, 2014, p. 139).

Hungary was also unable to leap into this modern political system in one single bound. Its first experiences with democracy go back to the interwar period. The second attempt to build a democratic system came after 1990, but this was preceded by the communist regime between 1947 and 1990. Deep social mobilization took place during the decades after WW2, and rapid economic growth characterized this period, however, this social mobilization was more motivated by politics, than by robust economic growth which declined from the early 70s to the mid-90s. So, it must not surprise us that clientelism again became the norm in the politics of the country after 1990. Between 1997 and 2006, a decade of fast economic growth followed which failed to generate a sustainable economic growth, allowing for modernizing the society and the state.

The weak rule of law might be the most characterizing element of this political system. Not only Hungary can be characterized by this weakness, but other Central European countries as well. As the case of Singapore and the early development of South Korea and Taiwan indicated, the rule of law can generate a rapid economic growth inducing the rise of the middle-class which wants its saying in formulating policies. This one is the last and most crucial element to democratic institutions. In the case of Hungary, democracy was not brought about by the rise of the middle class and fought by the middle class, but the collapse of the economic and political system of the country lead along with favorable external political conditions to the democratization of the country. This path is a very different one from that of the United Kingdom, the United States or South Korea. Germany and Japan were similar in the aspect that democratization only began after the total collapse of the political and economic system; however, by this time the two countries already had efficient state bureaucracy, which is not true for Hungary.

Table 1. Sequencing of elements of the political system



Source: own compilation

As a result of this historic development, the Hungarian political system is to be characterized by an incompetent state, clientelistic institution, the weak rule of law and a feeble middle class which is – this is the paradox – reliant on the mercy of the inefficient state. While the state is weak, and the economic institutions fail to bring about rapid growth, the demand for the paternalistic state only grows stronger. Against this backdrop, it might not surprise us that Hungary hesitates to go further in the European integration process despite the seemingly favorable external conditions of the country. There is no external military threat; embeddedness of Hungarian economy in the Single Market of the European Union is ensured which provides a large market to Hungarian firms, and unilateral economic benefits for economic development.

In times of economic turbulences, Hungary (along with other Central European countries, seems to lapse into a less authoritarian state, however, it is not the end of democracy, but rather the growth of clientelism.

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Opinion & Reviews

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Review of Shelton, Joel T. (2015) Conditionality and the Ambitions of Governance: Social Transformation in Southeastern Europe. New York: Palgrave Macmillan.

A review

The question of conditionality became a debated topic in general after the Euro crisis in the last years since 2009. At the beginning of the European project, in the 1950s conditionality was not on the table since the countries joining the economic integration were more or less on the same level of development. However, the southern enlargement of the European Union (EU) made it clear, that accession without being committed and believing in the same values cannot be successful. Thus, in 1993 the EU introduced the Copenhagen criteria (democracy, market economy, capacity to take on the obligations of the membership). For the countries intending to join the EU today, apart from the three criteria there are other requirements to be fulfilled. The reviewed book attempts to examine EU conditionality and tries to answer the question how deep does it impact the habits, mind-set, customs and everyday life of people besides the institutional rearrangement that the EU enlargement brings.

Putting contemporary International Political Economy (IPE) theories into a critical framework Joel T. Shelton analyses the concept of conditionality relying on authors from the 18-19th century such as Karl Marx, Max Weber and Adam Smith. The theoretical framework is followed by a case study that discusses the impact of the EU's conditionality on the social and subjective dimensions of life in a candidate country, Macedonia. Shelton's book is a unique development in the field of conditionality because it draws upon different theories as conditionality has not been theorised yet, and extracts the passages from these texts which are relevant to the study of social and subjective dimensions of life (such as habits, customs, the way of thinking etc.). His choice is based on the intention of proving that the main ambition of conditionality is to change the mindset and customs of people, in order to help maintain the political-economic system in which conditionality is imposed.

The main argument of the book is that conditionality needs to go beyond the mainstream IPE schools of institutionalism and rationalism, which only affect the surface of societies. Rationalism focuses on the bargaining process and a cost/benefit analysis, while institutionalism concentrates on the adaptation of rules and regulations on an institutional level. To illustrate, rationalism concentrates on the negotiation process during the enlargement, while institutionalism analyses the adaptation of the EU acquis and other requirements in the candidate countries. However, these levels do not always affect the everyday life of people, who are determinant actors in the success of conditionality. To make it clear, Shelton uses the example of Macedonia, which is a candidate to join the EU. Throughout the book the author constantly narrows the scope, as he begins from conditionality in general, then turns to EU enlargement, conditionality in the EU, instruments of conditionality and finally the focus is on the Operational Program for Human Resources Development (OP – HRD). In spite of the book's density, this methodology makes the book easy to read. The author concludes, although OP-HRD has great ambitions, there are several limits to its success, among others the lack of proper financial backing, the fragmented state of programming and evaluation and its heavy dependence on administration and bureaucracy.

Shelton's main message is that habits, customs and other deep aspects of human life cannot be changed with high-political interventions alone. The emphasis on the factors which might influence the aforementioned dimensions makes the book interdisciplinary and requires the author to use different theories to underpin his arguments. Thus, the text's density expects the reader to have some previous knowledge of IPE theories. Nevertheless, the book is particularly recommended to researchers interested in the whole European project, sociologists who are focused on the social and subjective dimension of everyday life, and in general to every social scientist.

Following the introduction, in the second chapter the author sheds light on the limits of IPE. While he criticises contemporary approaches to IPE he focuses on the mainstream American school. Although he mentions that the British school of IPE has a broader scope but his elaboration on that angle is limited. The American school resembles the techniques of pure economics and believes in the adoption of rational model of human behaviour. Such a rational IPE approach believes that actors act according to their preferences, calculate the difference between costs and benefits and make a rational decision.

Breaking rationality down, Shelton introduces two approaches that contribute to the discussion of conditionality, but lack the elements of social and subjective dimensions of life. This part of the study makes clear the limited status of mainstream, economics oriented IPE approaches among which the most important are rationality and institutionalism. On one hand, he explains EU enlargement as a rational bargaining game - based on microeconomics - where the actor's sole goal is the maximization of political benefit. Even if the calculation suggests that the state adopt EU rules and join the EU, the individual level stays intact. On the other hand, one can explain the Europeanization project as putting institutionalisation in focus rather than bargaining. However, as experience shows from the Central European countries' accession, norms can regulate interests. Even though the countries were not prepared for membership and the benefits were not assured in the first years (i.e. limited free movement of people), the norm of collective identity influenced the potential member states to join. According to Shelton, in this case the staff in the ministries and institutions of Central Europe was already Europeanised, which kept up motivation. Consequently, conditionality is driven by the socialisation of institutional actors. However, this approach still lacks the possibility to have an impact on the social and subjective dimensions of life.

In the third chapter, Shelton introduces the anxieties of classical political economy and builds on authors that go beyond the limits of institutionalism and rationalism. According to James Stuart governance must shape the circumstances through which self-interest operates. Furthermore, he said that the statesman has to adapt the spirit of the people to the changing circumstances in order to prevent disharmony. If disharmony occurs, the government has to restore it. Although Stuart includes social and subjective elements into the analysis, he trusts too deeply the knowledge of the statesman.

Adam Smith believed that an invisible hand promotes the interest of the society, but market societies are still prone to disharmony. Smith realised, that the society needs a "fellow-feeling" to function harmoniously. Under "fellow-feeling" he understood sympathy towards other human beings. However, division of labour can danger this sympathy since it leads to a new social stratification where people have different interests (the employees and the employers). According to Smith, to prevent this, the government needs to educate the society as a whole to maintain the social underpinnings of order and abundance. If the individuals are educated, they will admire the ones who are better and will work to be alike. However, Smith does not consider that disharmony might be induced from the wealthy class since they may look at the new educated layer as a competitor. To conclude, Smith understands the social dimensions of political economic life and he looks at education as a tool of maintaining order and abundance.

In the fourth chapter, Shelton discusses political economy in the context of the problem of conduct. He starts with Marx, as a criticism towards Smith because using Marx's line of thought there can be no "fellow-feeling" in a factory between the capitalist and the worker. In spite of this, normal effectiveness is a must when it comes to workers. In order to reach normality, the capitalist has a vital role in providing training. However, his training is not general but the one which is required by the shifting demands of the industry. Consequently, capital creates the human capital which is required for its own reproduction, and then it remakes the conditions of social relations to its own image. Furthermore, as the capitalist is reliant on consumption, he constantly remakes the tastes of consumers with innovations, to maintain abundance.

In the following, still under the umbrella of the problem of conduct, the author turns towards Weber, and examines the bureaucratic organisation as an influencing factor. Shelton deems that bureaucracy ensures the regularity of the operations of political economic harmony. According to Weber, the bureaucrat has to act rationally, and this rationality will drive the institution. Nevertheless, people are inherently driven by traditional habits and not by organisational rationality. This can only be reached by a long process of education, therefore educational institutions work on altering the subjective dimensions of life.

In the fifth chapter, Shelton turns to a case study where he begins with introducing three instruments of conditionality in the EU. The main element of prioritisation is the EU Progress Report which is put together by the European Commission for every candidate state on a yearly basis. The focus of the book is on chapter 19 (social Policy & employment) and chapter 26 (education & culture) of the accession chapters because these examine the social and subjective dimensions of life. The Reports are detailed concerning these topics, and require a lot of work in the field of education and the inclusion of excluded groups of society (i.e. women, Roma, Albanians). However, as the author concludes prioritisation is really fragmented and difficult to follow as the priorities are incoherent and vague.

The second instrument of conditionality is programming. The main tool of programming is the Instrument for Pre-Accession (IPA) provided by the EU. The IPA provides financial assistance for candidate countries in order to fulfil conditionality. However, only 9% of the budget is spent on human resources development, which is really low, compared to the 40% dedicated to institution building. Although the factual difference between these percentages is obvious but the author does not take into consideration the different cost requirements of the fields.

Finally, the third instrument is evaluation. The evaluation part monitors the fulfilment of membership criteria and it is partly overlapped by prioritisation, since it is carried out by the EU Progress Reports. However, the Progress Reports are repetitive which poses the question whether conditionality can reach success in the field of social inclusion. Although Shelton asks this question, it is not clear why does he relies on the Report since earlier he had made it explicit that the prioritisation (including EU Progress Report) is vague, incoherent and fragmented.

In the sixth and seventh chapter the book arrives at the narrowest part of the scope and analyses the OP-HRD, an IPA funded project focused on human resources development in Macedonia. OP-HRD attempts to reach normal effectiveness through education, because it believes in supply side economics: the increased number of skilled workers will lead to more jobs. However, it neglects structural disharmonies, surplus labour or the lack of demand. Furthermore, in terms of social inclusion it solely concentrates on the employment of excluded groups, and it does not consider that these societies have their own way of getting approbation apart from the labour market. Although Shelton does not mention, but here he refers to the danger of losing Smith's "fellow-feeling" by depriving the culture of minorities. Thus, the supported actions are limited to the neoliberal understanding of the person and society – work and consume. In the following pages the book proceeds to explain that, conditionality functions to widen participation in markets through education - which resembles Marx's idea about the capitalist, who needs to educate workers in order to remain capitalist. On the top of that, capacity building (education) depends on the behaviour of persons in organisations. In Weber's thought in such a bureaucratic body as the EU the bureaucrat's incorrect behaviour can undermine the project. Although a long process of education could help, but the funds dedicated to this element are limited in OP-HRD.

All in all, the ambitions of conditionality are really high but as there are too many obstacles, such as the lack of ability to absorb funds, lack of qualified staff or lack of funds the results of conditionality are not deep enough. The book states that the European project's integral goal is social transformation and this is done under a neoliberal umbrella. The social transformation is far from being deep enough and the institutional adaptation is not satisfactory to influence the social and subjective dimensions of life. However, the text is not normative in a sense of judging the neoliberal agenda. It does not say that it is detrimental to societies, neither that it is conducive for development. The book's main message is that transformation based on the technical anxieties of the neoliberal agenda cannot succeed because it is not deep enough. Relying on theoretical background we can see that the neoliberal discourse is not the first which tried to model people's minds - but it is the present one. Nevertheless, the constant failure of the neoliberal conditionality ensures its own survival, and that of the apparatus.

To conclude, the book sheds light on a gap in the literature and also on the failure of conditionality in the EU. The book's structure as it begins from a wider context and reduces the scope to one single programme of the EU makes it smooth and easy to follow. However, the analysis concerning the OP-HRD program is mainly based on official documents provided by the EU, which are even criticised by Shelton himself. Thus, a deeper analysis as a field-work of the effects of EU conditionality in Macedonia would make the study more credible.