CHINESE ECONOMIC DIPLOMACY AND THE EUROPEAN UNION

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INTRODUCTION

Rapid economic growth of China over the previous four decades has made it one of the key global players – including the world's largest exporter and increasingly important actor in the area of international investment and capital flows. In turn, China has also become the largest trading partner of the European Union (EU), an important destination for the European foreign direct investments (FDI), as well as an important investor within the EU. As such, economic exchanges with China have become a crucial aspect of the EU's foreign economic affairs, arguably creating a situation of mutual interdependence which both sides need to recognize and manage.[1]

But economic dealings with China always carry political and strategic implications. China continues to be ruled by a single-party regime of the Communist Party and, in fact, is growing more authoritarian at home and abroad in recent years. For the EU professing the values of democracy and human rights, this naturally produces a contradictory situation acknowledged also by the official formula of the European Commission that China is "a negotiation partner, an economic competitor, and a systemic rival".[2]

In this paper we will primarily focus on the economic diplomacy of the People's Republic of China (PRC, or only China) towards the EU, while also recognizing that it holds not only economic but also important political and strategic implications. This approach is based within our understanding of the economic diplomacy, first, as how states conduct their international economic relations to enhance national prosperity;[3] and second, how they use economic means as a leverage to promote strategic political interests.[4]

We will identify interests promoted by Chinese economic diplomacy (and the compatibility with the interests of European actors), areas in which Chinese policies are most notable, and the results of these activities. Thus the main research questions will be: what are the interests of China in terms of its economic diplomacy in the EU and what impact has Chinese economic expansion in the EU after the 2008 Global Financial Crisis had. Subsequently, we will also deal with the question to what extent are European actors – the EU and its member states – able to control and manage these activities in order to pursue their own goals.

In order to explore these issues, we decided to focus both at the EU policy level – as since the Treaty of Lisbon at the latest, the EU is an actor in this area – as well as at the level of the EU member states. Moreover, we will be describing separately the Chinese economic interactions with the older member states on the one hand, and with new post-communist newer member states in Central and Eastern Europe, on the other. This division is analytically useful, as the dynamics of Chinese economic penetration differ as a result of the varying context, developmental level, and structural position of these groups of actors. To

1 Additional research assistance provided by Nikola Majsniarová.

2 European commission. (2019). European Commission and HR/VP contribution to the European Council: EU-China - A strategic outlook. *European Commission*. https://ec.europa.eu/info/sites/default/files/communication-eu-china-a-strategic-outlook.pdf.

3 Bayne, N., & Woolcock, S. (2013). The New Economic Diplomacy Decision-Making and Negotiation in International Economic Relations. *Ashgate Publishing, Ltd., 2013, 3. Edition.*

4 Okano-Heijmans, M. (2011). Conceptualizing Economic Diplomacy: The Crossroads of International Relations, Economics, IPE and Diplomatic Studies. *The Hague Journal of Diplomacy Vol. 6 (1–2), 7–36.*

support the argument that the EU should be considered economic, political and regulative power and that this is well demonstrated by dynamics of economic relations with China, we are also comparing the results of Chinese economic diplomacy with the group of non-EU members in the Western Balkans.

The issue of Chinese economic interaction with Europe is not only important with regard to the size and gravity of Chinese economy, but also because of the specific qualitative features of the Chinese economic expansion which differs in a significant way from the political-economic model followed by the EU and its members states which is based on the liberal democracy, free market competition, non-discrimination, and transparency. In the EU, these rules apply to the trade with goods and services, as well as to the investments or public procurement, and all economic actors, including state owned enterprises (SOEs), are to compete equally and fairly with each other within the given regulatory framework, without any undue advantages.

On the other hand, China follows a model in which the state – in other words, the Communist Party – retains a much stronger role in the economy. Market mechanisms, including competition or price setting, are in such a model flexible only to the extent the state allows them to. In such a model, market competition exists – in fact, can be very rough – but it is often directly influenced by the state, which may actively support certain companies (be it private or state-owned ones), limit expansion of others, initiate merges or splits, and create other incentives to distort the market mechanisms and move the national economic activity in the desired direction. Economics in such a model is much more interlinked with politics than in the case of the EU. Naturally, political interests are of prime concern for the Chinese state and therefore political relationships are also the key assets for the businesses.

The Belt and Road Initiative (BRI), the flagship project of president Xi Jinping, is an ideal case to highlight many of the features of the Chinese model. Under the BRI, foreign governments negotiate loans (among many other forms of interactions) with Chinese banks, which may decide to offer concession terms if they deem it desired for various reasons, including non-economic ones (i.e. strategic and political). The emphasis is on large-scale infrastructure projects, which can be regarded as strategic and attract significant attention. They also often exceed a billion EUR mark and since they do not follow very high standards in terms of transparency and oversight, there are plenty of opportunities for corrupt behaviour and undue political influence on both sides. Hence, foreign government officials may use Chinese money to strengthen their political position and personally enrich themselves, while not paying sufficient attention to the issue of economic rentability of the project for their national economies. Chinese actors, too, operate in the context where they make decisions based on other than just economic prospects. This dynamics can lead to debt problems on the side of host governments, which may also be used as a political leverage by China.

As we will show in the paper, this typical model of the Chinese BRI deals, however, has not been applied in the EU due to the regulatory context – although it has worked out in a number of projects in the Western Balkan countries, as we will briefly discuss. Instead, Chinese subjects are involved in lots of conventional economic exchanges with the actors in the EU. Putting trade relations aside, Chinese companies (either SOEs or private ones) are investing into the European economy. Their greenfield investments or more often acquisitions, as well as participation in public tenders of European countries, would generally be done following the EU rules. At the same time, there are still some noteworthy aspects as Chinese subjects are sometimes targeting technology and know-how without obvious profit maximization strategy, they struggle with meeting their obligations in terms of transparency, environment or labour rights, and generally rely on the backing of their state and expect favours form host governments.

Building on this initial reading of the situation, we will focus in the paper primarily on the trade between the EU and China, on the issue of Chinese investment in the form of acquisitions and greenfield investments, foreign direct investment and loans by policy banks, but also on the specific area of Chinese participation in European public procurement. As was already mentioned, the specific Chinese model of interaction with Europe has been used and succeeded to varying degrees in different regions of Europe. While the interaction with old-member states was for Chinese subjects largely 'business as usual', in Central and Eastern Europe China attempted to enforce the "Chinese model", but mostly failed among the EU countries. The case of the non-EU Balkan shows that just outside the EU and its regulatory framework, the penetration by the

Chinese model of economic diplomacy was much more substantial.

In the subsequent section, we will begin by outlining China's strategic interests in general, and then in particular in relation to the EU and specifically in the area of economics. Then we will discuss Chinese economic interaction with the 'older member states', before moving in the following section to the case of the Central and Eastern European countries, including those in the Western Balkans. Finally, we will analyze the impact of Chinese economic diplomacy in Europe and the EU responses.

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CHINA'S STRATEGIC CALCULUS AND THE ROLE OF EUROPE

1.1 China's national interests and economics

The economic diplomacy of China in Europe is naturally driven by the broader strategic goals of China. In this section, we will thus begin by outlining China's strategic goals, the role of economics in general within these goals, and particularly how Europe fits in the picture.

It is always good to emphasize that China's strategic goals are solely defined by the Chinese Communist Party (CCP, or the Party). It is not surprising, then, that the key 'core' interest of China is regime security.[5] In other words, the CCP wants first and foremost to remain in power and is determined to do whatever it takes to preserve its rule. This includes the use of violence against opponents or whoever else the Party thinks may undermine its position.[6]

Although the CCP certainly does not shy away from utilizing oppressive tools, its rule also enjoys quite high levels of approval among much of the Chinese public who is generally satisfied with the status quo. This is mainly the result of the dramatic increase in material well-being over the previous four decades.[7] At the same time, China is still on average a developing country with much of its population hoping for a better future. To continue enjoying popular support, the CCP is under pressure to keep moving further up economically.

With the time going – and the increasing development level of China – it is becoming more and more difficult to preserve a high level of growth and continue fulfilling these expectations of Chinese people. Indeed, the GDP growth of China has been steadily slowing down since 2007 and in 2019 was officially 6,1 %. Although many other countries envy China for this number, there are question marks about how accurate the data are. The Chinese government may want to 'adjust' the official statistics to control overall sentiments, while provinces and regional governments – and their leaders – may want to inflate growth numbers to gain recognition and rewards within the system. Another issue is how much of the Chinese GDP is a result of various speculative activities, including real estate bubbles, generally useless projects (such as 'ghost cities') or others.

However, the most crucial challenge is how to preserve economic growth in the future. The Chinese 'economic miracle' started at the end of the 1970s with the 'reform and opening up' policy of Deng Xiaoping. Initially, it depended on an almost unlimited amount of cheap labour and some level of free-market forces being liberated and allowed to drive entrepreneurship. Utilizing an export-led growth strategy (previously adopted by Japan, Taiwan or South Korea), China has been a major beneficiary of the global liberal trading system, joining the World Trade Organization (WTO) in 2011 and becoming the world's number one exporter in 2009.

This was the time when China was the 'factory of the world', still relying chiefly on its vast amount of relatively cheap labour. As a result of the 2008 global

5 Dai, B. (2010). Stick to the path of peaceful development. *China Daily.* http://www.chinadaily.com.cn/opinion/2010-12/13/content_11690133.htm

6 Ringen, S. (2016). The Perfect Dictatorship: China in the 21st Century. Hong Kong: Hong Kong University Press.

7 Dickson, B. J. (2016). *The Dictator's Dilemma: The Chinese Communist Party's Strategy for Survival*. Oxford University Press.

financial crisis, however, the demand in the West (where China's most important customers are located) plummeted and the Chinese government had to find very quickly a new driving force for Chinese production. So began the massive investment into domestic infrastructure over the next decade when China produced the world's largest networks of highways, high-speed railways, subway systems, and constructed new airports, bridges, and more. With the time going, however, most of what might be counted as reasonable investment has been completed – and, again, a new driving force for economic growth was needed.

Besides exports, a key ingredient behind the massive economic upsurge was the foreign direct investment (FDI). China at the end of the 1970s was among the world's poorest and technologically least developed countries in the world, particularly after the previous decade of the Cultural Revolution interrupted higher education, research, and struck a terrible blow to China's human capital. Opening up to foreign capital and technology might seem like a natural step in retrospect, but it was a revolutionary change from the previous decades of isolation and autarky under Mao Zedong. Yet even Deng Xiaoping recognized limits to the opening when he said that "if you open the window for fresh air, you have to expect some flies to blow in".[8] In other words, the CCP allowed a certain level of opening up to the outside world, but did not entirely abandon its cautious outlook that such exchanges might bring in troubles for the single-party rule.

Indeed, since the 2008 crisis, the Chinese government has attempted to decrease its dependence on foreign markets and strengthen its own resilience. The international trade ratio has been decreasing afterwards, as the role of exports relatively speaking decreased and China has been increasingly substituting technologically sophisticated imports.[9] In the meantime, Chinese companies attempted to invest abroad to get rid of overcapacity of its capital and production, while attempting to get access to the high-end technology.

The EU has long played an interesting role in China's strategic calculations. Most fundamentally, the Chinese government has considered the EU as the third most important actor globally (after the US and China) and a necessary partner in the creation of a "multipolar" world order which should – in China's mind – replace the US hegemony. As such, China has hoped that the EU would be increasingly autonomous of the US – or at the very least would not enter into an anti-China alliance with the US.[10]

It remains an open question to what extent this has been happening, and also how China's own actions have helped or undermined these goals. Although the EU has remained more open to economic interaction with China, including in terms of investment and technology transfers, in recent years there has been a marked shift in the EU's attitude. Although the EU has not adopted (yet) the same policy towards China as the US, it will be much more difficult for China to get access to the cutting-edge technology of the EU companies, invest in critical infrastructure in Europe, or engage in technology cooperation with the EU-based entities.

1.2 The EU's political and economic relations with China

China is a crucial economic partner for the EU. After it overtook the US in 2020, it became the biggest trade partner for Europe. Even in the COVID–19 year trade developed dynamically (after a decline in 2019): in 2020, the EU–27 imported goods worth 384 bio. EUR from the PRC, while the exports amounted to 203 bio. EUR. The deficit is traditionally huge; 181 bio. EUR in 2020. The EU mainly imports industrial and consumer goods as well as machinery and equipment, footwear and clothing. The main export goods are machinery and equipment, motor vehicles, aircraft and chemicals.

Trade in services plays an increasingly important role: Almost 20 percent of the exports of goods to China are exports of services; conversely, the figure stands at more than 10 percent.

The outbreak of the COVID-19 pandemic in 2020 demonstrated how closely interlinked the European and Chinese economies are as China was found to be a chief producer of much needed medical goods. Con-

8 Shullman, D. O. (2019). Protect the Party: China's growing influence in the developing world. *The Brookings Institution*. https://www.brookings.edu/articles/protect-the-party-chinas-growing-influence-in-the-developing-world/.

9 The World Bank. (2020). *Data: Trade (% of GDP) – China*. https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS?locations=C.

10 Stec, G. (2021). "Correct choice" on strategic autonomy: What China wants from the EU. *Mercator Institute for China Studies (MERICS)*. https://merics.org/en/briefing/correct-choice-strategic-autonomy-what-china-wants-eu.

Table 1: Net Income from EU Funds (billion Euro) in period 2009-2019

	Czechia		Hungary		Poland	
	Net revenues from EU	Agricultural support	Net revenues from EU	Agricultural support	Net revenues from EU	Agricultural support
Total net revenues	31.99	12.59	45.44	18.00	113.12	48.91
Excl. agri. support	19.40		27.44		64.21	

Source: https://ec.europa.eu/budget/graphs/revenue_expediture.html.

sequently, discussions started about relocating the production of strategic, sensitive and dual-use goods to Europe or at least to other countries outside China to diversify supply and thus lower the risks. Vietnam, Malaysia and Indonesia proved especially attractive: their economies are well integrated in the trans-regional production chains and transport networks, but the wages are still lower than in China. For instance, the Austrian AT&S, a global leader in the production of high-end printed circuit boards, signed in 2021 an agreement to establish a new plant in Malaysia – in addition to its Chinese plant; the investments amount to 1.7 bio. EUR. However, relocations are costly and not always possible.[11]

Even though both Brussels and Beijing are interested in preserving the economic relations, there remain significant differences that impact negatively on the economic relations. The EU has long criticized what it considers unfair practises by China which include undue state support for own companies, state-owned as well as private ones. The Chinese market also remains much more protected than the European one. As a result, there is a lack of "level playing field" between Chinese and European companies who want to compete against each other in China, in Europe, and even in the third markets.[12]

As the free trade agreement with China was deemed unrealistic, it was decided that one way to narrow down the gap would be to establish a bilateral investment agreement between the EU and China which promised to increase operating space for the EU companies in China (previously, China had signed such agreements with almost all EU members individually). After more than seven years of negotiations, the Comprehensive Agreement on Investments (CAI) was agreed at the executive level in December 2020. However, due to China's human rights violations in the autonomous region Xinjiang it was soon put on hold. In March 2021, China retaliated against EU criticism and sanctions with harsh counter-measures, including against members of the EU parliament and independent research institutions, e.g., MERICS in Germany.[13] As a result, the European Parliament has frozen the ratification process and it is doubtful the agreement would ever be ratified.

Another of the hotly contested issues recently are Chinese investments in Europe, as there are discussions about the level of political control from the Chinese Communist Party over their decision-making and operations. The EU has set up a screening mechanism which will put some Chinese investments under scrutiny, particularly those in the critical infrastructure, high-tech and technology, information, media, and other which could have strategic and political implications.[14] This shift in the EU's attitude towards Chinese investments might have contributed to their decrease since 2016, reaching lowest volume in ten years in 2020.[15]

In March 2019, the European Commission and the High Representative of the Union for Foreign Affairs

11 European Commission. (2021). *China*. https://ec.europa.eu/trade/policy/countries-and-regions/countries/china/.

12 European Parliamentary Research Service. (2021). *EU-China Comprehensive Agreement on Investment: Levelling the playing field with China.* https://www.europarl.europa.eu/RegData/etudes/BRIE/2020/652066/EPRS_BRI(2020)652066_EN.pdf

13 Wintour, P. (2021). UK braced for Chinese retaliation over Uighur abuse sanctions. *The Guardian*. https://www.theguardian.com/world/2021/mar/23/uk-braced-for-chinese-retaliation-over-uighur-abuse-sanction.

14 Center for Strategic and International Studies web page. https://www.csis.org/blogs/strategic-technologies-blog/recent-developments-eu-foreign-investment-screening.

15 Kratz, A., Zenglein, M., & Sebastian, G. (2021). Chinese FDI in Europe 2020 update. Investment falls to 10-year low in an economically and politically challenging year. *Rhodium Group and the Mercator Institute for China Studies (MERICS), June*. https://rhg.com/wp-content/uploads/2021/06/MERICSRhodium-GroupCOFDIUpdate2021.pdf.

and Security Policy published guidelines for a new EU China strategy. The policy paper "*EU-China – A strategic outlook. Joint Communication to the European Parliament, the European Council and the Council*" sets a new tone in the perception of the PRC. China is labelled as a negotiating partner, an economic competitor, and a "systemic rival promoting alternative models of governance".[16] The last characterization signals a fundamental change in the relations with China. A more recent development is to view China in the broader regional context of the Indo-Pacific.[17]

The new EU 'China strategy' seems to rebuke the previous policy of integrating China in the existing international order while believing this inclusion would change China into a more liberal, Western-style system. This belief was especially strong after China's admission to the WTO in 2001. While the EU acknowledges that China has implemented some key reforms and liberalized its economy, there remains criticism, notably on the lack of transparency, discriminating industrial policies and non-tariff measures, strong government intervention resulting in a dominant position for SOEs, and, last but not least, the ongoing violation of intellectual property rights. The European Union Chamber of Commerce in China shares this critical view.[18]

The alternative models of order are both related to the international *political* system, including above all the United Nations and the stronger participation of the Global South which is also supported by Western countries, and the international *economic* order. The latter includes the World Trade Organization (WTO), the World Bank (WB) and the International Monetary Fund (IMF) as well as regional banks such as the Asian Development Bank (ADB). This system has been created and developed after the Second World War and therefore largely reflects the interests, norms and rules of the Western world. Criticism that it does not mirror the rise of China and other developing nations is therefore, to some extent at least, justified. Yet, for the West, it naturally presents a challenge and presents a potential of decreased international influence in future.

1.3 The Belt and Road Initiative as the flagship of Chinese diplomacy

China has been criticized for aiming at establishing its own model of economic order, utilizing the Belt and Road Initiative as one of the tools. Since its first announcement in Autumn 2013, the BRI has become a truly global project. Formerly known as "One Belt, One Road", it was introduced by president Xi Jinping in two speeches in Kazakhstan and Indonesia, respectively. Both locations are highly symbolic: In Central Asia, he presented the land-based silk road (the Silk Road Economic Belt), in Southeast Asia the maritime one (the 21st Century Maritime Silk Road).

The overall aim of the BRI is said to improve connectivity in the BRI participant countries and to better interlink the various participating regions. Infrastructure is the key focus and much of the BRI is driven by large construction projects such as railways, roads, ports, energy and telecommunication networks. In general, however, the BRI is supposed to also include connectivity in terms of trade, investments, as well as people-to-people relations.[18]

Europe features prominently in the BRI as the original concept was suggested along the lines of connecting two ends of the greater Eurasian continent – China and Western Europe – which are the important economic centres of the global economy. Central, Southeast and South Asia, the Middle East, and Africa then present the regions meant to be interconnected into this grand idea – and this is where most of the infrastructure building is supposed to be taking place. Besides, with the time going, Oceania as well as Latin America were included in the initiative, somehow obscuring the original concept of rebuilding the old Silk Road across Eurasia. Instead, the BRI has really become a flagship of Chinese economic diplomacy towards much of the world – with the few notable ex-

16 European commission. (2019). European Commission and HR/VP contribution to the European Council: EU-China – A strategic outlook. *European Commission*. https://ec.europa.eu/info/sites/default/files/communication-eu-china-a-strategic-outlook.pdf.

17 European Union Chamber of Commerce in China, & Mercator Institute for China Studies (MERICS). (2020). *Decoupling: Severed Ties and Patchwork Globalisation*. 1–101. https://merics.org/sites/default/files/2021-01/Decoupling_EN.pdf

18 Gerstl, A. & Wallenböck, U. (2021). Making analytic sense of the Belt and Road Initiative: A plea for multi- and trans-disciplinary approaches and eclecticism. In Gerstl, A. & Wallenböck, U. (eds.). China's Belt and Road Initiative: Strategic and Economic Impacts on Central Asia, Southeast Asia, and Central Eastern Europe. Abingdon and New York: Routledge, pp. 1–20.

ceptions such as North America and partially Western Europe.

The reason for this cautiousness is that many in the West regard the BRI as an economic tool of China to increase its geo-economic and geopolitical influence in various regions and on a global level. The question whether the BRI is such a tool is highly contested in the literature.[19] While some scholars and politicians claim that the BRI is a Chinese grand strategy to become the global hegemon, others argue that it is merely a broad bundle of aims, interests and policies but not a cohesive strategy.

Accordingly, the main drivers of the BRI are also contested: Are they domestic, economic, geo-economic or strategic motives and objectives?[20] The notion that BRI is a kind of basket for various diverging interests and policies is based on the argument that many domestic and economic aims are reflected in the BRI, not least the objective to develop the inland and Western provinces and export the overproduction. In addition, it took the State Council until 2015 to publish a comprehensive policy paper on the BRI.[21]

China stresses win-win cooperation under the BRI frame and uses the narrative that it provides global goods, ranging from the physical infrastructure to new norms and institutions. Indeed, most participant countries in the Global South require foreign loans, investments, technology and know-how to upgrade their infrastructure. Thus, in principle, Chinese engagement is welcome. Yet, Beijing has been criticized for engaging in a number of problematic projects which increase indebtedness, do not create sufficient economic activity, or undermine environmental, labour and other standards. Some of the examples are the ports of Hambantota in Sri Lanka, a highway in Montenegro, dams in Ecuador, or the railways in Kenya and Laos.[22]

China promised to spend about 1 trillion USD on BRI projects. Whether the BRI projects already total this sum is contested, as there exists no official database containing all BRI projects. Major reasons are that some projects started before the launch of the BRI and were later awarded the label 'BRI' and that some countries are reluctant to award bilateral projects with China the label "BRI" for political reasons. Therefore databases such as from the Asian Infrastructure Investment Bank (AIIB), MERICS or the American Enterprise Institute do not provide the full picture.[23]

China opens to some extent with the BRI new markets also for European companies, notably in Central Asia, but the competition there increases as well due to the more active engagement of Chinese enterprises. Moreover, the BRI has also reached Central and Eastern Europe, where Chinese enterprises try to compete with the established EU countries, such as those from Germany or Austria, for whom this has been a strategically crucial market.[24] The EU is concerned about Beijing's rules- and norm-setting power in the EU admission countries where the stricter EU competition laws and rules for tenders do not yet apply.[25]

19 Callahan, W. A. (2016). China's "Asia Dream": The Belt Road Initiative and the new regional order. *Asian Journal of Comparative Politics, 3*, 226–243.; Gerstl and Wallenböck 2021.

20 Heiduk, F., & Sakaki, A. (2019). Introduction to the Special Issue—China's Belt and Road Initiative: the View from East Asia. *East Asia*, *36* (2), 93–113. https://doi.org/10.1007/s12140-019-09312-y.

21 http://english.www.gov.cn/archive/publications/2015/03/30/content_281475080249035.htm

22 Patey, P. (2021). *How China Loses: The Pushback against Chinese Global Ambitions*. Oxford University Press.

23 The American Enterprise Institute & The Heritage Foundation. (2021). *China Global Investment Tracker*. https://www.aei.org/china-global-investment-tracker/

24 Gerstl, A. (2018). China's New Silk Roads. Categorising and Grouping the World: Beijing's 16+1+X European Formula. *Vienna Journal of East Asian Studies*, *31–58*. https://doi.org/https://doi.org/10.2478/vjeas-2018-0002.

25 Grübler, J. & Stehrer, R. (2021): Economic (policy) implications of the Belt and Road Initiative for Central, East, and Southeast Europe. In: Gerstl, A. & Wallenböck, U. (eds.): *China's Belt and Road Initiative. Strategic and Economic Impacts on Central Asia, Southeast Asia, and Central Eastern Europe*. London: Routledge, pp. 212–228.

2

CHINA'S ECONOMIC PRESENCE IN WESTERN EUROPE

Given media attention to Chinese investment in Central and Eastern Europe, and generally, China-CEE relations, one may be forgiven to think that China's economic activity in Europe focuses there. In reality, however, it is quite the opposite. Looking at where Chinese FDI within the EU concentrates, the CEE countries generally host by far the least amount of Chinese investments when compared to other EU countries. After Brexit, it is Germany who hosts the largest amount of Chinese FDI, followed by Italy, France, and Finland. In terms of the percentage share of Chinese FDI compared to the overall FDI stock, Finland is by far leading with over 12 % of its FDI made by China, followed by Greece (6.5 %) and Portugal (5.1 %).

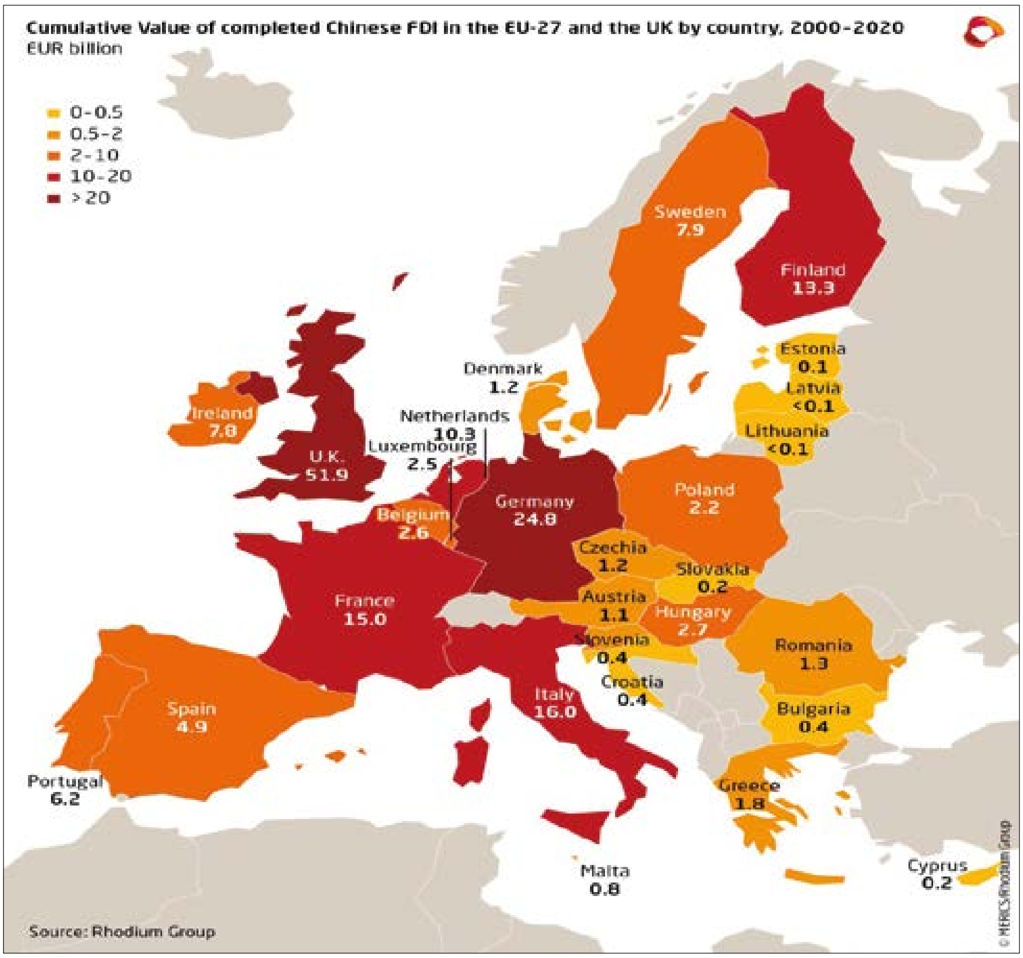
When it comes to trade dependency and particularly the EU exports to China, Germany is uncontested leader both in terms of absolute volume of its exports to China (over 100 billion EUR annually) as well as the highest share of China as an export destination (over 7 %), followed by the other Western and Northern European countries such UK, France, Netherlands, Sweden, and Finland. Thus the image that the Central and Eastern European countries are somehow uniquely economically dependent on China is wrong: actually, the economic dependency of other EU countries is arguably higher.

As it would be impossible to cover all the EU countries here, we have decided to focus on four which cover the three main EU countries from various European subregions, plus Austria, as a highly-developed country yet with less active economic exchanges with China, although directly relevant to the Central and Eastern European region.

2.1 Selected Western European countries: Germany, Italy, France and Austria

Both **Germany** and China are export-oriented nations whose economic relations deepened significantly in the last decade. During her 16 years in office, *Bundeskanzlerin* Angela Merkel from the Christian Democratic Party (CDU) travelled frequently to China, usually taking prominent business leaders with her. Merkel has been criticized for promoting economic and business interests, while in general seeking to accommodate China politically. Until 2019, she also preferred a bilateral approach towards China rather than a robust common EU policy. In its Indo-Pacific strategy of 2020 Germany states its aim to contribute, together with the EU, to shaping the regional order in the Indo-Pacific. It should be based on multilateral rules rather than the right of the strongest – an implicit criticism of China. Even though Armin Laschet from the CDU will likely become the new *Bundeskanzler* after the election in September 2021, the Greens, the most probable coalition partner, have a much more critical view on China than the currently ruling CDU-Social Democratic coalition.[26] Whether economic exchange will further flourish, if the German government becomes more vocal about human rights violations in China, remains to be seen.

26 Reimers, A. (2021). Veränderung in der deutschen China-Politik? Ein Blick in die Wahlprogramme. *Mercator Institute for China Studies (MERICS)*. https://merics.org/de/kurzanalyse/veraenderung-der-deutschen-china-politik-ein-blick-die-wahlprogramme.



Source: MERICS and Rhodium Group

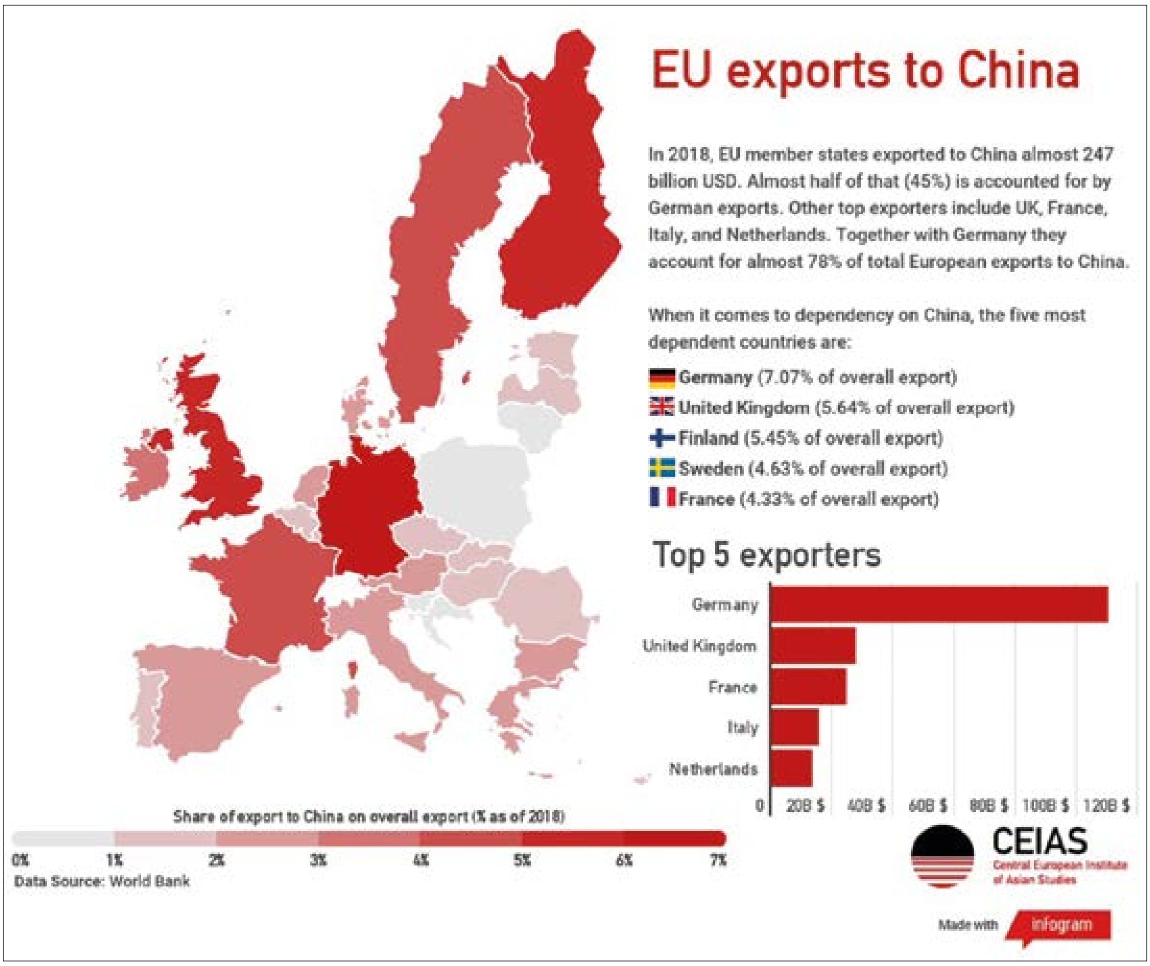
China is, since 2016, Germany's biggest trade partner. Trade in total amounted to 213 bio. EUR; however, the Netherlands (172 bio. EUR) and the US (171,5 bio. EUR) follow suit. Germany imported from the PRC goods worth 117 bio. EUR, while the exports stand at 96 bio. EUR.[27]

All major German carmakers have production plants in China – the PRC is for most of them the main market. The dependency of German carmakers – and thus of the German economy in total – on China goes hand in hand with an indirect dependency of the automotive industry in Austria, the Czech Republic, Hungary and Slovakia where most supplier companies produce for German companies.

In turn, China is also a prominent investor in Germany. The majority of investments are in sectors identified by the Communist Party of China as key industries, notably in biomedicine, robotics and the automotive sector. The takeover of the world-leading German robotics company Kuka by the Chinese firm Midea in 2016 raised the awareness of political and economic decision-makers as well as the broad public of growing Chinese influence not only in Germany but the EU in general.

Another shock for the EU and its members was the signing of a Memorandum of Understanding on the BRI by **Italy** in March 2019. Italy is so far the only G7 country which has signed such document with China. However, the new Italian government under Prime Minister Mario Draghi is much more critical towards China. Yet, China remains economically engaged, e.g., through investments in the ports of Genoa and Trieste. Both ports are designed to play an important role in the BRI: Transport goods shipped via the maritime silk road will be via Genoa and Trieste diverted to trucks or trains and further transported to other European countries. Chinese companies, including COSCO, also invested in smaller ports such as Vado Ligure and Ravenna.

27 Kratz, A., Zenglein, M., & Sebastian, G. (2021). Chinese FDI in Europe 2020 update. Investment falls to 10-year low in an economically and politically challenging year. *Rhodium Group and the Mercator Institute for China Studies (MERICS), June.* https://rhg.com/wp-content/uploads/2021/06/MERICSRhodium-GroupCOFDIUpdate2021.pdf



Source: CEIAS

For China, **France** is economically even more important than Italy. Before the COVID–19 pandemic the imports from China developed less dynamically than the French exports, amounting to 20 bio. EUR in 2020 (–4 bio. EUR). Alibaba and Huawei have regional headquarters in the Hexagon. During his state visit in France in March 2019, Xi signed economic agreements, including the purchase of 300 Airbus jets and of containerships built by CMA CGM. Also signed were joint projects of French and Chinese banks and technological companies.

Debates about Chinese investments in sensitive sectors, however, are also heated in France, although criticism of Chinese businessmen for buying traditional French vineyards is more symbolic. All in all, France is economically less affected by Chinese investments and acquisitions. President Emmanuel Macron plays a leading role in convincing other EU member states, including Germany, to shift from a bilateral approach in dealing with China to a jointly agreed EU position, as the EU–27 have together much more leverage than individually.

While China does not even rank among **Austria's** top-10 export partners, it surpassed Italy as second largest import country in 2020. Concerning investments, Austrian companies invested more in China (5.5 bio. EUR until 2019) than Chinese enterprises in Austria (3 bio. EUR). Nevertheless, some Chinese acquisitions raised concerns. Chief among them is the takeover of Diamond Aircraft and FACC. Diamond builds planes and drones and was acquired by Wanfeng Aviation Industry. The Aviation Industry Corporation of China has a 91.25 percent share of FACC, an aerospace and defence company.

In 2018, the Austrian Chancellor Kurz and President Van der Bellen, other leading politicians and a huge delegation of business leaders visited China. Thereby many economic agreements were signed, but no far-reaching Memorandum of Understanding on the BRI.[28] At the Second Belt and Road Forum in 2019

28 Schnauder, A. (2018). Wie Charme & Harmonie zum "Wirtschaftsturbo" in China werden. *Der Standard*. https://www.derstandard.at/story/2000077691305/wie-charme-und-harmonie-in-china-zum-wirtschaftsturbo-werden.

Table 2: Western Europe – China trade (select years) (value in billion USD; share in percent)

		2000		2008		2011		2019	
		Export	Import	Export	Import	Export	Import	Export	Import
Germany	**Value**	8.30	12.70	49.10	72.40	87.90	91.40	107.00	96.90
	Share	1.59	2.79	3.48	6.76	6.11	7.90	7.48	8.34
France	**Value**	3.11	6.52	13.60	33.70	18.90	42.80	23.60	45.20
	Share	1.05	2.11	2.27	4.79	3.20	5.94	4.22	7.02
Italy	**Value**	2.37	5.66	9.73	32.58	14.00	39.10	14.70	34.90
	Share	1.00	2.48	1.83	5.70	2.70	6.90	2.80	7.27
Austria	**Value**	0.51	0.72	2.90	4.22	4.19	5.08	5.26	6.58
	Share	0.82	1.10	1.73	2.47	2.49	2.83	3.07	3.76

Source: The Observator of Economic Complexity Data, https://oec.world

Kurz emphasized in talks with Chinese politicians the importance of the rule of law, transparency and human rights.

Strategically, Austria faces the challenge of the 16+1 format and thus China's attempts to engage politically and economically Austria's "near abroad". The markets in Central and Eastern Europe and the Western Balkans are extremely important for Austrian companies as they are among the top investors in the region. According to some firms, they were already discriminated against Chinese competitors in some non-EU countries.[29] The Bank of China and the Industrial and Commercial Bank of China established since 2015 their regional headquarters in Vienna, as a signal that indeed China, too, perceives Austria as a regional hub when it comes to promoting and managing the BRI projects.

While penetration of the European market by Chinese exports and large trade deficit with China is still considered to be an important issue for European economic policy, it is fair to say that this problem was more characteristic for the first decade of the 21th century. Since the start of the second decade, the Chinese trade penetration slowed down significantly and the trade deficit in general declined. The Chinese "Go Out" policy could be seen as a reaction to the fact that China's growth model (built on foreign investments and production of goods for export) is gradually running out of steam. These trends could be further reinforced by COVID shock to the globalized world economy and by the revision of the attitude towards China by the West.

It does make sense that the most sensitive issue regarding economic relations with China currently are foreign direct investments.[30] It is undoubtedly true that the volume of Chinese investment has grown rapidly in the last decade. However, as with foreign trade, the trend in recent years has been a marked slowdown. From the peak in 2016 with 44.2 billion EUR of FDI flowing from China to the EU, it decreased to 11.7 billion in 2019 and further to 6.5 billion in 2020.[31]

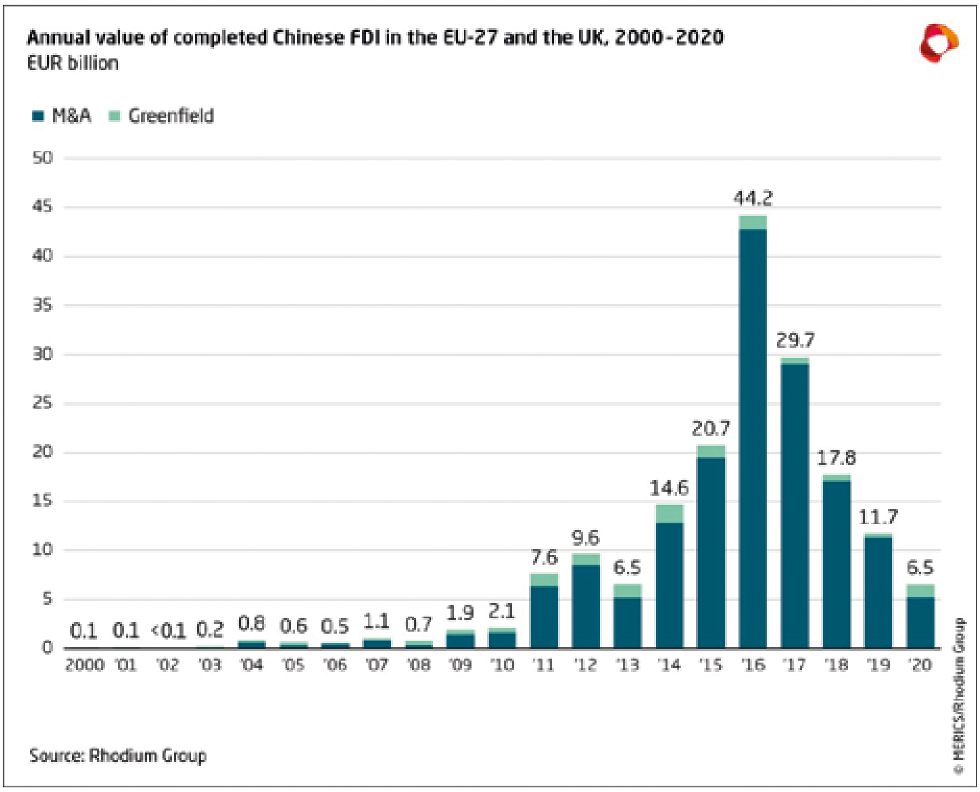
Even more important is the character of these FDIs, as only a fragment of Chinese investments are greenfield investments, preferred by the EU, the vast majority are mergers and acquisitions. The average share of greenfield investments in the last decade was merely 6.5 percent. It is the EU who realized much more greenfield investments in China and as a matter of fact, invested more into China in the last two decades

29 AHK Greater China. *Market Entry & Expansion*. https://china.ahk.de/services/market-entry-expansion.

30 Rogelja, I., & Tsimonis, K. (2020). Narrating the China Threat: Securitising Chinese Economic Presence in Europe. *The Chinese Journal of International Politics*, *13*(1), 103–133. https://doi.org/https://doi.org/10.1093/cjip/poz019.

31 Kratz, A., Zenglein, M., & Sebastian, G. (2021). Chinese FDI in Europe 2020 update. Investment falls to 10-year low in an economically and politically challenging year. *Rhodium Group and the Mercator Institute for China Studies (MERICS)*, *June*. https://rhg.com/wp-content/uploads/2021/06/MERICSRhodium-GroupCOFDIUpdate2021.pdf

32 Kratz, A., Zenglein, M., & Sebastian, G. (2021). Chinese FDI in Europe 2020 update. Investment falls to 10-year low in an economically and politically challenging year. *Rhodium Group and the Mercator Institute for China Studies (MERICS)*, *June*. https://rhg.com/wp-content/uploads/2021/06/MERICSRhodium-GroupCOFDIUpdate2021.pdf



Source: MERICS and Rhodium Group[33]

than the other way round.[33] The recent trends shows that this is not going to change in the near future. Regarding our selected countries, while the dynamic inflow of Chinese investments was high, growing from a very low base, they cumulatively represent only a relatively small portion of total FDI stocks in individual economies.

Table 3: Chinese inward FDI stocks in Western Europe (billions USD, share in percent)

	Pre-BRI		Present	
Germany	Value (2013)	3.16	Value (2018)	12.65
	Share (2013)	0.33	Share (2018)	1.35
France	Value (2012)	1.18	Value (2019)	12.22
	Share (2012)	0.17	Share (2019)	1.41
Italy	Value (2013)	0.27	Value (2019)	5.30
	Share (2013)	0.07	Share (2019)	1.19
Austria	Value (2012)	0.72	Value (2019)	1.23
	Share (2012)	0.43	Share (2019)	0.63

Source: https://www.oecd-ilibrary.org/

33 Irwin-Hunt, A., & O'Farrell, S. (2021). EU-China investment deal – a data perspective. *FDi Intelligence*. https://www.fdiintelligence.com/article/79306.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3

CHINESE EXPANSION INTO CENTRAL AND EASTERN EUROPE

3.1 Chinese economic diplomacy and Central Europe

Central and Eastern Europe (CEE) has attracted a significant degree of Chinese attention in the post-2008 period. Many countries in the region have been rethinking their predominantly neoliberal economic policies and development strategies. In many respects, the relationship with the EU has become more problematic, whether due to slow economic convergence linked to the unprecedented control of economies by Western multinationals, or a reticence towards the political and cultural model promoted by the EU (cosmopolitanism, transnationalism, liberalism), all reinforced by the European migrant crisis 2015–2016. Thus, in addition to the economic reasons for which Western capital was entering the region, the CEE region was also interesting for China in the context of the realisation of geostrategic objectives.[34]

In this part, we are focussing on three countries of Central Europe – Poland, Hungary and Czechia, as they represent the majority of trade exchange and investment flows of the CEE region with China. Main goal of these countries, for decades, has been to return to the European political, cultural and economic space. From the outset, there were a number of reasons for the failure of Chinese economic and public diplomacy in this way. The countries of the region are more strongly anti-communist and anti-socialist than Western Europe. The population has a strong aversion to propaganda, and the narratives of the attractiveness of Chinese culture had arguably little hope of success.[35] Moreover, Central European societies are not exactly renowned for their susceptibility to other ethnicities, races and particularly non-European cultures.

It was therefore reasonable to expect that the establishment of intensive cooperation with Communist China would be conditional on its considerable and widely acknowledged economic benefits to the general public. Conversely, the sense of belonging to Western European civilisation in the cultural, political and security spheres was further strengthened by events in Ukraine in 2014. China's close relationship with the Russian leadership has only reinforced cautiousness among Central European political elites and the general public.

However, there is another remarkable aspect: China has chosen a model to penetrate the CEE region that it explicitly referred to as "South-South cooperation", designed for cooperation with developing countries, accenting common shared past (of Communism) and catching up with the West.[36] As it turned out, this approach was completely inappropriate for economic interaction with relatively developed countries with advanced economies in an area controlled by Western capital and under the political, cultural but also regulatory influence of the European Union.

34Turcsányi, R. Q. (2020). China and the Frustrated Region: Central and Eastern Europe's Repeating Troubles with Great Powers. *China Report*, *56*(1), 1–77. https://doi.org/https://doi.org/10.1177/0009445519895626.

35 Turcsányi, R., & Qiaoan, R. (2020). Friends or foes? How diverging views of communist past undermine the China-CEE '16+1 platform.' *Asia Europe Journal*, *18*(3), 397–412. https://doi.org/10.1007/s10308-019-00550-6.

36 Kowalski, B., Nolan, P., & Gerrits, A. (2017). China's foreign policy towards Central and Eastern Europe: The "16+1" format in the South–South cooperation perspective. Cases of the Czech Republic and Hungary. *Cambridge Journal of Eurasian Studies*, *1*, 1–16. https://doi.org/10.22261/7r65zh.

3.2 Central European turn towards China

The global financial crisis has hit Central Europe harder than the core Western European economies and has therefore also sparked the first serious discussions about the success and sustainability of a development model based on trade and FDI inflows from the West. As the pace of foreign investment inflows and international trade fell sharply, the unprecedented dependence on Western Europe began to be seen more seriously as a problem for the first time. Especially in Hungary, at a time of the introduction of unorthodox economic policies and clashes with the EU, the possibility of cooperation with China began to look attractive.

Of course, cooperation with Communist China cannot be taken for granted in any of the countries of the region. While the achievements of the largely market-based Asian economies of Japan, South Korea and Taiwan were respected in Central Europe, in the case of China it was a strange turn for the self-styled anti-socialists Orbán or Kaczyński. The most likely explanation for their course of action is probably the vision of unprecedented opportunities to be exploited, while in some cases China was adopted also for symbolic political purposes to increase leverage vis-a-vis Brussels.

Slogans such as Hungary's „Eastern Opening" or Poland's „Go China" have also been noted in the West European media. Despite their media catchiness, it cannot be said that there was any sophisticated strategy behind them. While there is no disputing that the slogans of cooperation with China were heard from many quarters in the Central European region in the period 2010-2015, there is relatively little evidence of any deeper, ideological turn towards China or replication of any major aspects of the Chinese economic or even social model. Speech of Hungarian prime minister Orbán is often quoted here, mentioning illiberal, Eastern countries (including China, which was explicitly mentioned) as an alternative that surpasses the Western model of civilization in its effectiveness.[38] One can also cite Czech president Zeman's announcements about breaking free from Western subjugation and serving as China's unsinkable aircraft carrier in Europe, or visiting China to learn how to stimulate economic growth and stabilize society (2014 and 2016).[39] In some sense, Kaczyński's (the leader of the Law and Justice party) idea of the need for a cultural counter-revolution against the liberal consensus is also a revision of a particular ideological attachment to the contemporary West. However, looking more closely at the development of relations between Central Europe and China, even these statements are rather pragmatic statements, conditioned by the specific context in which they were used and with limited explanatory value in terms of representing attitudes and sentiments in their own society.

3.3 The failure of Chinese expansion into Central Europe

In order to understand the failure of the policy of economic cooperation with China, it is necessary to realise that the interests of the two sides – Central Europe and China – are different and in some respects mutually exclusive. China had several reasons for trying to penetrate Central Europe economically. Its intention was to reach the Western European market, not only with its goods, but also with its services, including engaging in competition for public procurement. Outside of the most developed Western economies, the main interest was in large infrastructure projects. These could use surplus Chinese investment capital and employ Chinese design, construction transport and IT firms with surplus production capacity and material. The infrastructure built would improve physical access to EU markets, while gaining experience and references by implementing projects directly within the EU.

While in Western Europe Chinese investments (acquisitions, joint ventures) aim at access to know-how, technologies and innovations (including their co-development with EU partners on EU territory), such opportunities are rare in Central Europe. China's overall objective in the current decade is to modernise its economic structure and climb the ladder of production complexity, technology, knowledge and human capital intensity.

37 Tóth, C. (2014). Viktor Orbán's speech at the XXV. Bálványos Free Summer University and Youth Camp, 26th July, 2014., Băile Tuşnad (Tusnádfürdő). *The Budpest Beacon*. https://budapestbeacon.com/full-text-of-viktor-orbans-speech-at-baile-tusnad-tusnadfurdo-of-26-july-2014/.

38 Bajerová, A., & Turcsányi, R. Q. (2019). Between defender of values and faithful ally: Czech approaches to China in the prism of role theory approach. *Studia Orientalia Slovaca*, *18*(2), 93–120.

Table 4: Chinese Inward FDI Stocks in the era of BRI and Eastern opening policy (billion USD)

	Total inward FDI stock (1)		China related projects (2)		Chinese investment (3)	Chinese FDI stock (4)	Chinese FDI stock as share of total FDI stock
	2012	**2020**	**2012**	**2020**	**2000-2019**	**2020**	**2020**
Czechia	136.5	188.8	0.00	0.86	0.84	0.33	0.18%
Hungary	104.4	101.0	3.48	5.88	3.59	3.91	3.87%
Poland	199.0	248.7	0.10	2.81	1.27	2.52	1.01%

Sources:
(1) https://data.oecd.org/fdi/fdi-stocks.htm.
(2) https://www.aei.org/china-global-investment-tracker/.
(3) Kratz et. al 2021.
(4) CEECAS 2020.[40]

Unlike Japan, South Korea, or Taiwan – which have been undergoing deindustrialization and used Central Europe as off-production site covering the EU – most Chinese companies and the government do not have such goals yet (and may never have, considering the massive size of China and internal inequalities between Chinese provinces). In terms of the political dimension of China's strategy, the economic presence, together with the space for public diplomacy, should have led to a gain in support for foreign policy interests and a reduction in anti-Chinese and pro-Western and pro-American sentiment in the region.

On the other hand, the countries of Central Europe had very different interests. They sought investment capital (potentially on concessionary terms) to compensate for shortfalls in inflows from the West and to diversify their dependence on the West. Investment was to be directed preferentially towards building new production facilities, technological and logistics capacities, creating new, high-quality jobs, bringing in new technologies and knowledge. Chinese investment was thus intended to accelerate the modernisation of domestic industry and shift the economic structure towards a higher value and intensity of technology and human capital. Infrastructure development in the region was to link the Asian and Western markets, with Central Europe participating in the provision of transport and logistics services and increasing its exports both to the West and, especially, to the Chinese market of unlimited possibilities. An important interest of Central Europe was to develop cooperation with China, but in a way that would not damage their relations with the EU – access to the common market and to European funds was always seen as a vital interest in Central Europe.

Seen from this perspective, there is no doubt that the dynamic diplomatic development of China-CEE relations in a decade following the 2008 crisis must be considered a clear failure for most of the actors involved, including China and the CEE countries. Such an assessment is justified in all the dimensions outlined, in terms of investment, trade and individual projects. Overall, Chinese investment in the region is low in terms of volume, its dynamism is weak and it is not clear that foreign policy of the CEE countries has led to any considerable change in line with China's strategic interests (besides a few symbolic steps and announcements by Hungary and a few other countries). The development of bilateral trade must be disappointing for the key players, both in terms of export volumes and trade deficits. Only a few projects with Chinese participation have been launched, most have been problematic from the outset in terms of efficiency and profitability, and have shown an extraordinary rate of failure.

In the case of Hungary, China-related projects represented 3.5 billion USD in 2012 and in the era of Eastern opening (and BRI) increased by app 2.4 billion USD. In 2020 there was probably around 3.9 billion of Chinese FDI stock in Hungary (as not all spending on China-related projects could be considered FDI inflow). That represents less than 4 percent of total foreign direct investment stock in Hungary.

Of the total USD 3.5 billion of Chinese investment before 2012, USD 1.5 billion is attributable to a sin-

39 Tamás, M. (2021). *Chinese Investment in Central and Eastern Europe: A reality check. Central and Eastern European Center for Asian Studies.* https://1585552c-d0b7-4a71-b606-c7fabbfa86da.filesusr.com/ugd/72d38a_373928ea28c44c7f9c875ead7fc49c44.pdf.

gle acquisition – the takeover of Hungary's largest chemical company (since 2006 under the control of a London-based investment company) by China's Wanhua in 2011. Since 2000, there have been a number of Chinese greenfield investments in Hungary: Wescast – Bohong (automotive), Yanfeng (automotive), Hisense (electronics), ZTE (telecommunication services) some of them may be further developed into larger operations. Most notable are operations of Huawei since 2009 with supply centre, assembly operations, logistic and innovation centre. Since the announcement of Eastern turn, there have been several other investment projects: Unisun photovoltaic, BBCA citric acid factory, BYD Electric bus, Kaposvar photovoltaic or Lenovo factory. Besides acquisition of BorsodChem by Wanhua, we could also mention Tureawll by Zhejiang Kaishan Compressor (geothermal power plant) which may represent development of domestic corporations.

This group of investments, even though rather limited in scope and impact on the economy of Hungary, could be considered in line with interests of Hungary as it increases the available investment capital and creates employment opportunities (some even could represent some technology transfer or upgrading). Different cases are acquisitions of international businesses by Chinese subjects, which also have operations in Hungary. Examples are acquisition of KUKA Hungaria, JOT automation, PEX automotive systems or solar panel producer KACO. Even though the Hungarian government operates with these as with examples of Chinese investments in Hungary, in reality, they have typically no impact on the economy. All these are examples of investments within normal competition within the national market. However, none of them reach the level where they could be considered a game changer for national development.

Projects of a very different kind are those, which was to be realized within the China model.[40] There were a number of large Chinese projects, with the full support of intense political relations announced during Premier Wen Jiabao's 2011 visit, confirmed by Vice Premier Li Keqiang in 2012. With the (though still questionable) exception of the Budapest-Belgrade railway, they all failed. A total of USD 3.6 billion was to be invested in the acquisition of MALÉV Airlines by China's HNA, the construction of the Vát cargo airport, the construction of a high-speed railway between Budapest and the international airport, or the construction of a freight railway line around Budapest (V0) – none of these projects were implemented. The projects had common characteristics: problematic economic returns, naive perceptions on the Hungarian side about the favourable terms of Chinese investment and China's ignorance of the European regulatory framework.

The Belgrade-Budapest railway aims to build an important part of the BRI backbone in the region connecting the Chinese-owned port of Piraeus (since 2009) with Budapest. The construction is highly controversial. The Hungarian section was to be completed in 2017–2018 at a cost of HUF 472 billion. The updated project foresees a cost of HUF 949 billion and the start of work in 2021. The majority (85%) is to be financed by an interest-bearing loan from China's Exim Bank. The return on the project is very doubtful, the Piraeus-Belgrade section has not yet been negotiated and for the overall rational might be even more critical than the Serbia-Hungary section.

Thus this is an important example of a project that was initiated politically with questionable economic rational. An important lesson from the operations of Chinese companies in Europe is the independence of their real business activities from the pronouncements of government delegations and agreements. Chinese officials readily repeat slogans about Central European countries as gateways for Chinese investment in Europe, or as logistics and transport hubs for Chinese trade. Private companies, having mapped out the economic opportunities and conditions, are not interested in doing business in the region – excluding competition from Western companies.

On trade, the 2012 Warsaw 16+1 summit formulated a target of dynamic growth of trade between CEE and China to USD 100 billion by 2015, roughly double the volume of 2011. In the case of Hungary, trade was to grow twice as fast as that of the other regions. In fact, the growth of Hungary's exports to China in particular has been modest. Its share of total exports rose from 1.32 percent in 2008 to 1.95 percent in 2011. Then, in the era of the 'Eastern opening', it actually decreased. In the same period, Germany's growth was from 24.1 percent to 26.9 percent. Imports from China then fell even as a share of total imports from 7.14 percent to 6.15 percent in the Eastern opening era. Still, Hungary's deficit remained substantial – $4.98 billion in 2011 and $5.27 billion in 2019.

40 Krpec, O., & Wise, C. (2021). *Grand Development Strategy or Simply Grandiose? China's Diffusion of Its Belt & Road Initiative into Central Europe.* https://doi.org/10.17632/hvcxg836fv.1.

Table 5: China-CE Trade (select years) (value in billion USD; share in percent)

Hungary

		2000		2008		2011		2019	
		Export	Import	Export	Import	Export	Import	Export	Import
China	Value	0.08	0.98	1.31	6.86	1.99	6.97	1.79	7.06
	Share	0.26	3.05	1.32	6.59	1.95	7.14	1.48	6.15
Germany	Value	9.84	8.27	23.80	25.00	24.70	21.90	32.60	28.90
	Share	32.90	25.70	24.00	24.00	24.30	22.50	26.90	25.20

Source: The Observator of Economic Complexity Data, https://oec.world.

In Poland, the BRI was associated with huge expectations. It was to some extent reflected in the Chinese activities in the sectors of transport infrastructure and the energy sector. More than in other countries, Chinese firms have applied for public tenders. Most noteably, COVEC won the tender to build a section of Warsaw – Berlin highway, however, it was not able to finish the project and withdrew, creating a major PR problem for Chinese economic involvement in Poland and beyond.[41]

However other Chinese firms succeeded in the tenders and managed to finalize the projects: energy infrastructure by Pinggao in 2014 and by Sinohydro in 2017; Wroclaw waterway system developed by Sinohydro; also road bypass and A2 highway sections to be realized by Stecol. Same Chinese firms are involved in the project of construction of Rail Baltica as part of the Polish-Chinese consortium – a project co-funded by the EU. Therefore it is clear that Chinese companies are able to compete within transparent public tenders in the EU. At the same time, questions may still exist about their motives, as some argue that Chinese offers are unrealistically low and primarily aimed at market access, rather than delivering immediate profit.

On the other hand, there are only several greenfield investments by Chinese subjects. TPV facility producing Philips brand electronics was established already in 2008. Other examples are Nuctech (security inspection equipment) and Hongbo (LED lightings) factories. Guotai-Huarongs car battery factory has been discussed for several years. Other projects were canceled, some of them for security considerations by the Polish side: 5G network by Huawei or multimodal park in Lodz. Large project was planned for the development of the Jan Karski mine by a Chinese and Australian firm, which is blocked by the Polish government. Most important acquisitions are purchase of Novago (waste management) by Everbright, Dressta Machinery (heavy machinery) by Liugong, Fabryka Lozysk Tocznych by Tri Ring Group, notable is acquisition of Appol by SDIC Zhonglu. There are also examples of international acquisitions by Chinese investors, through which these acquired operations in Poland. Most important is the purchase of shares in EDP Renováveis, Portuguese owner of power plants in Poland or acquisition of Louvre Hotels by Jin Jiang. Possibly the largest acquisition was purchase of 100 percent share of Logicor from Blackstone by Chinese CIC – portfolio included 28 logistic parks in Poland. All these are examples of operations of Chinese subjects on the market.

Attempts to apply the Chinese model in Poland completely failed. There was much discussion initially about Chinese financing and massive involvement of Chinese SOE in several major infrastructure projects: Central (Solidarity) Communication Port near Warsaw, New Central Port in Gdansk, Malaszewicze intermodal ports and logistic centre or planned nuclear power plants. Not only these projects were not realized, but Chinese involvement is highly unlikely or even ruled out by leading politicians for the future.[42]

41 Pendrakowska, P. (2018). Poland's perspective on the Belt and Road Initiative. *Journal of Contemporary East Asia Studies*, *7*(2), 190–206. https://doi.org/10.1080/24761028.2018.1552491.

42 Jakubowski, A., Komornicki, T., Kowalczyk, K., & Miszczuk, A. (2020). Poland as a hub of the Silk Road Economic Belt: is the narrative of opportunity supported by developments on the ground? *Asia Europe Journal*, *18*(3), 367–396. https://doi.org/10.1007/s10308-020-00571-6.

Table 6: China-CE Trade (select years) (value in billion USD; share in percent)

Poland

		2000		2008		2011		2019	
		Export	Import	Export	Import	Export	Import	Export	Import
China	Value	0.12	1.40	1.37	16.10	1.97	17.50	2.98	26.90
	Share	0.38	2.80	0.87	7.85	1.10	8.27	1.17	9.82
Germany	Value	10.90	12.50	35.70	49.80	43.40	50.40	68.40	69.60
	Share	34.50	25.10	22.70	24.30	24.10	23.80	26.70	25.40

Source: The Observator of Economic Complexity Data, https://oec.world.

Even the notable improvement in bilateral political relations – President Duda said for instance on a visit to China in 2015 that President Xi Jinping understood the dynamics of Central Europe well – has not brought the expected results. In the area of trade with China, Poland failed to realise any of its objectives during the period of the Eastern turnaround. Despite its position directly on trade routes, exports to China grew only slowly, their share in total Polish exports improved very little in the period 2011–2019 (from 1.1% to 1.0%). At the same time, the trade deficit with China widened further (from USD 15.5 to 23.9 billion). Amount of Chinese investments is generally low. Chinese FDI represents in 2020 only 1.01 percent of total inward FDI stock.

The Czech Republic as a traditional producer and exporter of engineering capital and consumer goods is naturally engaged in the Chinese market. A number of Czech companies supply engineering units and power generation equipment, and some (typically in the form of a joint venture with a domestic company) manufacture in China. The most important link is through Skoda Auto, for which the Chinese market is the most important national market. As part of the VW group, it has produced about 3 million cars in China. The production of the brand's models, however, takes place in five plants of SAIC Volkswagen Automotive Company (a joint venture of a Chinese and German company established in 1984), so it is neither an export of a Czech product nor an investment of a Czech company in a narrow sense. Beyond that, the notion of unlimited sales opportunities on the Chinese market is unfounded.

A look at trade statistics shows that Czech exports to China grew substantially in the immediate post–2008 period, then at a rather average pace in the pro-China turnaround period. Imports were essentially stagnant during this period and declined as a share of total imports. Chinese investment in Czechia is very low, around one billion USD, and represents mere 0,2% of total inward FDI stock.

The main success of the Czech-China economic cooperation was supposed to be the push into the Chinese market by the PPF group and its subsidiary Home Credit (a consumer credit company with 20 million clients in China), supported personally by President Zeman. However, again, the PPF is registered and pays taxes in the Netherlands, so the economic benefits for the Czech economy is highly doubtful, beyond the personal interests of those directly involved in the business, obviously.

More significant in terms of further developments was the establishment of cooperation between the Czech-Slovak investment group J&T and the Shanghai-based China Energy Company Limited (CEFC) – agreed during president Zeman's visit to China in 2014. The CEFC – through its subsidiary CEFC Europe – was the main actor in the influx of Chinese investment into the Czech Republic. In 2015–2016, the company acquired a minority stake in J&T, acquired brewery, Airlines and travel agency, media company, football club, engineering company ŽĎAS and several office and historical buildings in Prague. Altogether, the CEFC has basically taken most of the estimated one billion USD of Chinese investment in the country.

However, even this fell far short of expectations. At the outset of the President Xi Jinping visit in Prague in 2016, President Zeman announced €4 billion of

Table 7: China-CE Trade (select years) (value in billion USD; share in percent)

Czechia

		2000		2008		2011		2019	
		Export	**Import**	**Export**	**Import**	**Export**	**Import**	**Export**	**Import**
China	**Value**	0.8 3	0.69	0.86	12.00	1.59	18.30	2.59	20.40
	Share	0.28	2.14	0.64	8.67	1.27	12.20	1.30	11.70
Germany	**Value**	11.70	10.80	39.20	37.60	46.30	39.20	61.90	47.50
	Share	39.30	33.70	29.40	27.00	30.30	26.00	31.20	27.20

Source: The Observator of Economic Complexity Data, https://oec.world.

deals in 2016 alone and €10 billion within three years. Detailed exploration of the announced projects shows that many of them were never serious intent, some of them were even fraud. Except for a very short list of minor greenfield investments (TV sets produced by Changhong and Hisense, canned meat by Shanghai Maling), none of these investments matched even remotely the host country's preferences – and even these greenfield investments can hardly be considered as creating quality high-tech jobs.

There were some discussions about Chinese involvement in large BRI related projects („Odra, Elbe, Danube" canal by Sinohydro, or Dukovany nuclear power plant expansion by China General Nuclear Power), but they were never close to the realization. Today, the involvement of Chinese companies in such projects (as well as realization of the 5G network is, according to most state representatives, out of the question due to the changed political climate in the Czech Republic and more broadly in the EU and NATO.

To add insult to injury, shortly after the buying spree by CEFC in 2016, the investment company collapsed. In March 2018, CEFC CEO Ye Jianming – an official advisor to President Zeman – disappeared in China as he was arrested by Party investigators on corruption charges. As part of the crisis communication, Chinese state-owned bank CITIC stepped in and bought CEFC's portfolio in the Czech Republic to prevent even more chaos related to the Chinese investments in the country.[43]

The combination of disappointment with the results of economic cooperation with China and the shameful role of the CEFC has contributed to the strong shift away from China on the Czech political scene. Since 2019, then, there has been an open political rift between the Czech Republic and China. The problems were further exacerbated in the autumn of 2019, when the President of the Czech Senate, planning a trip to Taiwan, received a letter from the Chinese embassy warning of the economic consequences of such a foreign trip. The trip was delayed by the coronavirus pandemic and took place in mid–2020, prompting strong reactions from China and international attention.[44]

In recent years, Poland has also seen a trend away from cooperation with China. While the BRI is still seen as a meaningful platform for cooperation, the US-backed Three Seas Initiative (an infrastructure programme focusing on energy, transport and digital networks linking the Baltic, Adriatic and Black Sea) seems more promising for Poland at the moment. What's more, beyond the economic challenges, at the 2018 NATO conference in Hamburg, Prime Minister Morawiecki described China as a challenge to NATO and the democratic world. Also, in 2018, the Polish Foreign Minister issued a statement on cyber threats from China.

During the period of Central Europe's Eastern turn, the region was seen by the West as a new bastion of pro-China sentiment. However, if we look at the

43 Garlick, J. (2019). China's principal–agent problem in the Czech Republic: the curious case of CEFC. *Asia Europe Journal*, *17*(4), 437–451. https://doi.org/10.1007/s10308-019-00565-z.

44 Šebeňa, M., & Turcsányi, R.Q. (2021). Divided National Identity and COVID–19: How China Has Become a Symbol of Major Political Cleavage in the Czech Republic. *China Review 21*(2), 35–63. https://www.muse.jhu.edu/article/794497.

attitudes of the public in Central European countries, pro-Chinese attitudes are not very pronounced in international comparison. In December 2019, 47% of Poles, 40% of Hungarians and 27% of Czechs had a positive attitude towards China. This is not too different from the 37% of residents of the old member states (only 26% in the case of the US). Even more interesting is the confidence in President Xi Jinping's policies. Only 18% of Poles, 17% of Czechs and 14% of Hungarians expressed confidence in him – i.e. less than in the US (37%) and the old EU member states (26%). While only 36% of Hungarians did not trust him directly, the figures for Czechs and Poles were 53% and 51% respectively.[46]

3.4 Perceptions of Western Europe on Chinese expansion into Central Europe

In the context of the internationally widely discussed rise of populism and the decline of democracy in Central and Eastern Europe, the Chinese-initiated and led 16+1 platform was viewed with concern by the West. The older EU member states considered the risk of China applying a divide-and-rule strategy to what they considered the EU's soft underbelly to be real. In the context of China's 'Go out' strategy, it was logical to expect that Chinese efforts at economic cooperation could lead to the acquisition of considerable influence over these countries.

Part of the concern was that countries in the region might lobby for Chinese interests within the EU's complex decision-making mechanism, further undermining the EU's capacity to act. Equally, the massive Chinese economic presence in Central Europe could be a problem for the competitiveness of firms from Western countries, which by locating some production activities in Central Europe maintain a price competitive ability against Asian producers in particular. Similarly, the modernisation of Central European transport and IT infrastructure, financed by the EU funds, could have been used by Chinese firms to increase their efficiency. Already in 2012, the European Commission proposed that EU member states should not allow access to public contracts to firms from countries that do not allow EU firms to compete in their own tenders.[45]

In this context, the 16+1 platform could then appear to some as a club of Eurosceptic countries where Chinese economic and political influence is growing. These fears have come to the fore again with the entry of Greece into this structure (hereafter referred to as the 17+1) in 2019. In reality, however, the Central European countries' positive signals towards China have only been isolated and largely symbolic. While the EU as a whole continued to criticize China, most Central European countries took a pragmatic stance by not blocking the EU position but also not being too vocal individually.[46] There were a few notable exceptions in both directions as, on the one hand, Hungary (and Greece) indeed vetoed some China-critical motions within the EU; yet, on the other hand, Lithuania or the Czech Republic conducted some positive steps towards Taiwan which also went out of the general (more catious) EU line.

With the time going, however, the fact that China's presence in the region has remained very limited has gradually become apparent and more widely recognized. This is also evident in the evolution of the EU's perception of the 16+1 platform – the summits, according to observers, did not do much and did not pose a risk to the EU. The EU has also gained observer status within the 16+1 platform and its observers were present at the summits and other related events.

As can be seen, fears that China will buy up Central and Eastern Europe 'on the cheap' have proved unfounded. Central European countries are extremely integrated into the core of the EU, their economies are firmly embedded in the production chains of Western European companies. EU structural funds are a difficult-to-replace source of capital. European grants have dramatically outstripped the Chinese capital: the CEE countries received about €182 billion in EU funds in the period immediately before the Eastern turnaround (2007–2013). Moreover, what China seems to have remarkably underestimated, is the EU's regulatory and structural power in the region. The EU has

45 Silver, L., Devlin, K., & Huang, C. (2019). China's Economic Growth Mostly Welcomed in Emerging Markets, but Neighbors Wary of Its Influence. *Pew Research Center*, 1–45. https://www.pewresearch.org/global/2019/12/05/chinas-economic-growth-mostly-welcomed-in-emerging-markets-but-neighbors-wary-of-its-influence/.

46 Rühlig, T., Jerdén, B., Putten, F.– P., Seaman, J., Otero-Iglesias, M., & Ekman, A. (2018). *Political values in Europe-China relations* (Issue December). European Think-tank Network on China (ETNC). https://www.ui.se/globalassets/ui.se-eng/research/asia/full-report-web-version_updated_2019.pdf.

Table 8: Net Income from EU Funds (billion Euro) in period 2009-2019

	Czechia		Hungary		Poland	
	Net revenues from EU	Agricultural support	Net revenues from EU	Agricultural support	Net revenues from EU	Agricultural support
Total net revenues	31.99	12.59	45.44	18.00	113.12	48.91
Excl. agri. support	19.40		27.44		64.21	

Source: https://ec.europa.eu/budget/graphs/revenue_expediture.html.

exclusive competence in customs policy, competition policy and common trade policy. All of this makes it highly unlikely that China will be able to get what it is looking for in the region, namely privileged access for its companies and capital, backed by a developing political relationship.

3.5 Chinese investments in the Western Balkan

Very different results of Chinese involvement in non-EU Balkan countries supports the argument that EU membership works as a formidable firewall against Chinese economic expansion. Non-EU Western Balkan countries are lacking the integration into EU's single market and to large extent also access to the EU funds. Most importantly, the EU laws, rules, and regulations do not apply here. Of course, there are differences in the level of economic developments and institutional framework, but even these are to a substantial extent the result of absence of serious pre-accession reform efforts and EU's leverage. Here China successfully – at least in the terms of economic involvement – applied the South-South strategy with all consequences. To check the involvement, the EU will need to come up with some kind of integration of this region into the EU's economic and regulative sphere.

Here, we would like to briefly characterize the Chinese encounter of the Western Balkans and quantify and compare the penetration with Central (and consequently Western) Europe. We are focusing on those characteristics, which differ most from the failure of expansion to the CE and different models of penetration of the WE. These characteristics make the economic relationship of the Western Balkans with China a problem for all actors (Western Balkans, EU and even China) and could be considered a reason for the EU to react.

Three main characteristics of Chinese projects in non-EU Western Balkans are problematic: rentability, environmental unsustainability and absence of transparency. Many Chinese projects make little economic sense. Coal power plants economic viability assessment, for instance, is not taking into consideration rising costs of burning coal and limited perspective within contemporary environmental sustainability policies, which will be enforced by EU and international community. Boljare to Bar highway in Montenegro (funded largely by a Chinese loan and built by Chinese companies) does not have prospect to generate sufficient economic activity which would return the massive spending of the Montenegro taxpayers' money.[47]

It should be stressed that most of the money coming into the region is within the Chinese model – these are not Chinese investments (neither private or public) *per se*, but loans from China to be repaid by the host states. The obvious consequence is widespread concerns regarding the debt owed to China may become a tool of influence for Beijing in the region. For example Montenegro owes 39 percent of its external debt to China, also North Macedonia (both NATO members) app 20 percent. Also in the case of other countries the exposure is substantial 14 percent in the case of Bosnia and 12 percent in Serbia. One billion USD Chinese Exim bank loan for highways in Monte-

47 Mladen, G. (2017). Chinese infrastructural investments in the Balkans: political implications of the highway project in Montenegro. *Taylor & Frances, 7*(1), 42–60. https://doi.org/10.1080/21622671.2017.1359106.

negro increased the debt-to-GDP ratio to 80 percent in 2018 and 103 percent in 2020. Montenegro formally requested the European Union's help in repaying the debt to the Exim Bank of China in March 2021, although this was refused.[49]

Belgrade, Sarajevo, Skopje, Pristina are among the world's most polluted cities. While most EU members have made efforts to phase out coal, Western Balkans is turning to Chinese money for expansion of unsustainable plants, energy and industry. Most Chinese projects fall desperately short of EU environmental standards. Chinese state-owned companies have been involved in five coal projects in Europe, all in non-EU western Balkans (most notable Kostolac power plant, including lignite mine; Stanari and Tuzla power plants and Smederevo steelworks). This is locking Balkans into a high-carbon future and unsustainable debt – a massive step away from EU integration.

Distant and unclear perspective of EU membership decreases the incentive to produce policies compatible with EU's priorities and principles. Together with economic problems and historical burdens, politicians in the Western Balkans are ready to sign Chinese loans or sell state assets in order to protect some particular economic interests. Business with China is readily politicized, state-to-state deals are often not made public.

The EU is of course not ignorant of these problems. Within the EU-Western Balkans summit in May 2020 EU offered more financial support to Balkans, as EU seeks to put a check on Chinese expansion into the region. There is a Western Balkans Investment Framework which finances among other infrastructure projects in Western Balkans through a mix of loans and grants with transparent governance procedures. What more, the EU has allocated 11.7 billion EUR through an instrument for pre-accession assistance (IPA II). It should be stressed that stricter conditions, including institutional and political reforms means project realization is slower (also e.g. in Serbia the condition of normalization of relations with Kosovo is a very sensitive one). The EU's pledge of 3.3 bill. EUR in support of the post-pandemic recovery in the Western Balkans is also relevant here.

As we mentioned above – while there is some general tendency in all Chinese economic operations, it has been proven several times in Europe, that Chinese actors can play by the rules of the host countries, but only if they are made to. And the EU's regulatory framework supported by the economic power of the bloc is capable of achieving that, in contrast to the situation in the Western Balkans.

3.6 Comparison of CE and non-EU Balkan in terms of Chinese projects

There was basically only one single project in the Central Europe which has been attempted to follow the 'Chinese model' – the Budapest-Belgrade railway.[49] Even this one has been controversial, seriously delayed, and it remains doubtful whether it would be realized. On the other hand, many projects which were announced or considered within the same model failed, possibly worth as much as 17 billion USD. The rate of success of Chinese projects in Central Europe is therefore very low. According to our findings, there were possibly 16 Chinese projects realized within Western model in CE, worth around 3.7 billion USD. These could be considered as 'true' Chinese investments into the region. Even here, another 11 projects worth 6.3 billion USD have failed. It is important to remind, that these successful Chinese investments are a mere fraction of the capital which continue to flow from the traditional destinations of FDI into the region and there is no evidence that the share of Chinese investment into the CE is increasing in recent years.

Three CE countries reflected in this study have a combined market of 58.7 million consumers and GDP (PPP) of 2.1 trillion USD. They represent a much larger market than the non-EU Western Balkan countries – Serbia, Bosnia, Albania, Macedonia and Montenegro with combined market of 15.8 million consumers and 271 billion USD (PPP) GDP. However, in the Western Balkan countries there were probably 14 projects within the China model worth 7 billion USD. Another 10 projects worth 6.9 billion were not realized or are highly problematic. This creates a big disparity in the level of exposure to Chinese financial penetration – in this regard repre-

48 Nielsen, N. (2021). EU refuses to bail out Montenegro's China loan. *EU Observer*. https://euobserver.com/world/151512.

49 Krpec, O., & Wise, C. (2021). *Grand Development Strategy or Simply Grandiose? China's Diffusion of Its Belt & Road Initiative into Central Europe*. https://doi.org/10.17632/hvcxg836fv.1.

senting loans from China. Only a very limited amount of money (possibly around 500 million USD) entered Western Balkans from China in the form of foreign direct investments, within the Western model.

This great disparity reflects higher levels of development in the CE, integration to the EU, access to the EU funds, but also the EU's regulatory framework and political influence.

3.7 Reasons for the failure of the Chinese strategy in Central Europe

The collapse of China's attempt of economic penetration of Central Europe is an event of wider international significance. It suggests the relative weakness of contemporary China in many dimensions of power in the international environment and, conversely, the (perhaps surprising, to some) strength of the West in general and the EU in particular. To many Western scholars, the moment of the coincidence of the Eastern turn of the Central European countries and China's Western expansion seemed optimal for far-reaching change. Hungary and to some extent Poland explicitly articulated a policy of weakening dependence on the West and diversifying economic partners. Even the Czech Republic – albeit to a lesser extent – began to discuss the question of the appropriate position in the international division of labour.

In the same period, China has actively offered its expertise and resources, within the narrative of exporting a unique development model that should allegedly respect national independence and autonomy in policy choices. In fact, it was precisely the issue of national independence and policy autonomy that was gaining importance during the period. Western reflection feared the export of a political style of pragmatism and assertiveness from China to Central Europe, just at a time of the rise of populism and the deterioration of the quality of democracy. Remarkably, China has not exported any version of its ‚developmental state' model to Central Europe. There has been minimal demand for such a model on the part of the Central European countries – the shift from extremely open economic policies to some degree of economic nationalism, neo-Mercantilism and industrial policies has taken place typically within the Western and European tradition of economic policy. The French, German, and American national economic traditions have addressed the issue of catching up with the economic leader in detail, both theoretically and practically.

The aim of Chinese policy was to deploy its own surplus financial capital, using economic and political asymmetry to negotiate privileged market access for its own firms, which were running out of opportunities on the home market. They were to implement projects guaranteed by host governments, preferably without having to compete with established regional players. The result was supposed to be increased penetration by Chinese exports of goods and services (construction, transport, IT), but also long-term commitments to China's largest banks. A concomitant phenomenon would then be China's growing economic and political influence in the region, which could be used to pursue foreign policy interests. This model has been used relatively successful in developing regions and, as we briefly outlined, also in the non-EU Western Balkan countries.

It has failed in Central Europe nonetheless which has instead further strengthened its economic links with the West (in terms of trade, investment and the intensity of its involvement in production chains). As far as political power is concerned, even in this sensitive period (the rise of Euroscepticism, populism, the Euro crisis, the migration crisis, Brexit), it has been confirmed that integration and membership in the EU and belonging to the Western security-political architecture have no alternatives in Central European countries. China's assertiveness towards the West and its support for the regimes and their policies in the case of Russia, Syria or Venezuela have contributed significantly to this awakening.

It is debatable, to what extent was the failure a result of naivety, misinformation and poor coordination between the activities of Chinese political leaders and companies. Alternatively, the result could be attributed to the power of the EU and the West (both hard power and soft power). It is this power and approach which needs to be applied if the EU wants to play a similarly efficient role in enforcing its rules and priorities, and checking China's influence in other non-EU Eastern European countries.

Table 9: China involvement (infrastructure, energy, ITC) in Central Europe (Czechia, Hungary, Poland) and non-EU Balkan (Albania, Bosnia, Macedonia, Montenegro, Serbia)

			Central Europe		Non-EU Balkan	
			No. of projects	App. value	No. of projects	App. value
Bridges, roads, railways, canals	**China model**	**Realized or likely**	1	2,660	7	4,057
		Problematic or failed	4	2,349	4	2,218
	Western model	**Realized or likely**	3	1,223	1	94
		Problematic or failed	4	1,115	0	0
Airports, airlines, ports, terminals	**China model**	**Realized or likely**	0	0	1	90
		Problematic or failed	5	6,246	1	2,200
	Western model	**Realized or likely**	1	848	0	0
		Problematic or failed	0	0	0	0
Conventional Energy - coal, nuclear power plant, power lines, substations, oil field, refinery; mining	**China model**	**Realized or likely**	0	0	3	2,277
		Problematic or failed	1	6,500	5	2,439
	Western model	**Realized or likely**	2	228	1	427
		Problematic or failed	5	4,452	0	0
Renewables energy	**China model**	**Realized or likely**	0	0	2	366
		Problematic or failed	0	0	0	0
	Western model	**Realized or likely**	7	749+	0	0
		Problematic or failed	2	680	0	0
ITC – smart networks, communication, education	**China model**	**Realized or likely**	0	0	1	170
		Problematic or failed	2	1500	0	0
	Western model	**Realized or likely**	3	626	0	0
		Problematic or failed	0	0	0	0
Total	**China model**	**Realized or likely**	1	2,660	14	6,960
		Problematic or failed	12	16,598	10	6,857
	Western model	**Realized or likely**	16	3,674	2	521
		Problematic or failed	11	6,274	0	0

Source: https://data.mendeley.com/datasets/hvcxg836fv/1.

4

EU'S REACTION TO CHINESE ECONOMIC POLICY

As we have indicated on several occasions throughout the paper already, it was the robustness of European economy, deep economic integration of all regions of the EU, the resilience of European institutions and policies (with important contribution of the convergence funds), and the legitimacy of shared interests and regulatory framework (e.g. transparency, sustainability, rules on public procurement or state aid), which worked as efficient firewall against the more assertive elements of Chinese economic diplomacy. It was the new member states of the CEE region, which were primarily addressed by Chinese economic diplomacy, thus we have focused much of our analysis on them – although its share in overall EU-China economic exchanges is marginal.

What made Europe uneasy are the manifestations of China's proactive *industrial policy* which affected both – the EU's economic core as well as the European peripheries. In the last 15 years, the EU's perception of China as well as some level of policy response was evolving. Before the 2008 GFC, the main pressing issue was the trade deficit with China. The prevailing perception was that China is overcoming the stage of development which requires strong industrial policy and will be progressively integrated into international division of labour and engaged as regular members into multilateral regimes.

This changed to some extent, with the inauguration of the Belt and Road Initiative in 2013 and strategy Made in China 2025 in 2015. EU communication "Elements for a new EU strategy on China from 2016"[50] highlighted the problems of Chinese subsidies, lack of respect for intellectual property rights and industrial overcapacity of some sectors of the Chinese economy. The **EU-China Connectivity Platform[51]** was established in 2015, declaring to seek to improve synergies between the existing EU's programs (most importantly Trans-European Transport Network) and China's BRI. The purpose of the document was mainly to articulate the European interests: levelling the playing field in transport infrastructure development – meaning fair and transparent public procurement and competition, reciprocal access to Chinese markets (export of goods, services and investment). The export group should have selected pilot projects for mutual cooperation – the preferred projects were rail corridors and multimodal hubs preferably through Balkan peninsula. It is therefore obvious that this framework was a direct response to the growing activity of Chinese BRI diplomacy on the EU's periphery.

In 2018 the European Parliament voiced concern that Chinese economic diplomacy, leading to creation of the 16+1 platform, is threatening the European integration project and the economic interest of European business. While inaugurated as a platform for economic cooperation of China and countries of Central and Eastern Europe already before BRI, it soon became the axis around which the envisaged cooperation was to take place. The EU report mentioned the BRI as a Chinese tool for shaping globalization to its interests.[52] The European parliament voiced concern

50 European Commission. (2016). JOINT COMMUNICATION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL Elements for a new EU strategy on China. In *HIGH REPRESENTATIVE OF THE UNION FOR FOREIGN AFFAIRS AND SECURITY POLICY*. https://eur-lex.europa.eu/legal-content/en/ALL/?uri=celex:52016JC0030.

51 European Commission. (2015). *The EU-China Connectivity Platform*. https://ec.europa.eu/transport/themes/international/eu-china-connectivity-platform_en.

52 European Parliament. (2021). Prospects for EU-Asia connectivity: The "European way to connectivity." *Briefing*, *April*. https://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_BRI(2021)690534.

that the 17+1 platform is becoming a tool of Chinese debt trap diplomacy. In consequence, the new communication "**Connecting Europe and Asia** – Building Blocks for an EU strategy" was published in **2018**.[53]

This EU-Asia Connectivity strategy is so far also a channel to proclaim the EU's goals and interests in relation to the infrastructure projects relating to Europe. Newly stressed elements were the sustainability of the projects and investment gaps in some regions – European neighbourhood countries and Central Asia. It seems, however, that there are no specific projects designated or designed at the present moment. Also, there was not yet decided what will be the general strategy for putting these ideas into practical realisation. The more active strategy with the potential to influence or even reverse the development in the neighbouring countries, where China is most involved, would be to create a European Development Bank to actively invest in the infrastructure while promoting the EU's rules of play. Alternative is to continue in existing programs but to allocate more money to the sensitive regions. Based on our discussion of the result of Chinese BRI diplomacy, this may well be sufficient and it seems that the EU is moving in this direction. For example, TEN-T program was in 2019 extended to the countries of the Eastern Partnership and intends to spend 13 billion Euro in the region by 2030.

So far, the reaction of the EU towards the Chinese (BRI) economic diplomacy was limited and mostly consisted of formulating principles and objectives or extending existing policies. On the other hand, the issues of levelling the playing field, dealing with subsidies and state aid, disproportionate market access or acquisition of strategic assets was dealt with more ambitious and novel instruments.

In communication "EU-China – a strategic outlook"[54] from 2019, the issue of insufficient market openness, Chinese subsidies for state-owned enterprises, industrial policy (directly reacting to the Made in China 2025 program) and the problem of geopolitics connected to the "debt-trap diplomacy" in Europe, was addressed. China is perceived to be all: necessary partner in combating climate change, a competitor on the global market and systemic rival in world's geopolitics.[55]

Instead of leading by example, the EU in recent years is gradually turning to coordination of effort to develop effective instruments to deal with China related issues. The more important initiatives are the EU-China comprehensive agreement on investments (CAI)[56] and the FDI screening mechanism.

The CAI was negotiated for several years and concluded in December 2000. Contains the list of sectors, which China is supposed to make more investment friendly. China is committed to matching the EU's level of openness in these sectors – has agreed to eliminate joint venture requirements, forced transfer of technologies, equity caps, and quantitative restrictions. This was considered a notable success of the German presidency, however the ratification by European parliament is in question because of a diplomatic row regarding EU imposed sanctions on the Chinese officials who are believed to be linked to human rights violations in Xinjian region. As a result of Chinese counter-sanctions against the EU, the European parliament froze the ratification process.

The sensitive issue of Chinese acquisitions of European companies controlling cutting-edge technologies, or having strategic importance for EU or member states, was addressed by introduction of the EU's FDI screening mechanism.[57] Since 2017 the Commission has been calling for a unified approach and more control over inflow of foreign investments. The regulation was adopted in 2019. The core is a cooperation mechanism for the exchange of information between state and commission. The Commission issues opinions on investment that may threaten EU security, public order or strategic projects. The focus is on early determination of whether the investor is controlled by the government of a third country or is already involved in a project affecting security or public order. Commissions' opinions on the issue have to be taken into consideration by member states.

53 European Commission. (2018). *JOINT COMMUNICATION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF THE REGIONS AND THE EUROPEAN INVESTMENT BANK: Connecting Europe and Asia – Building blocks for an EU Strategy*. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018JC0031&qid=1627311273944.

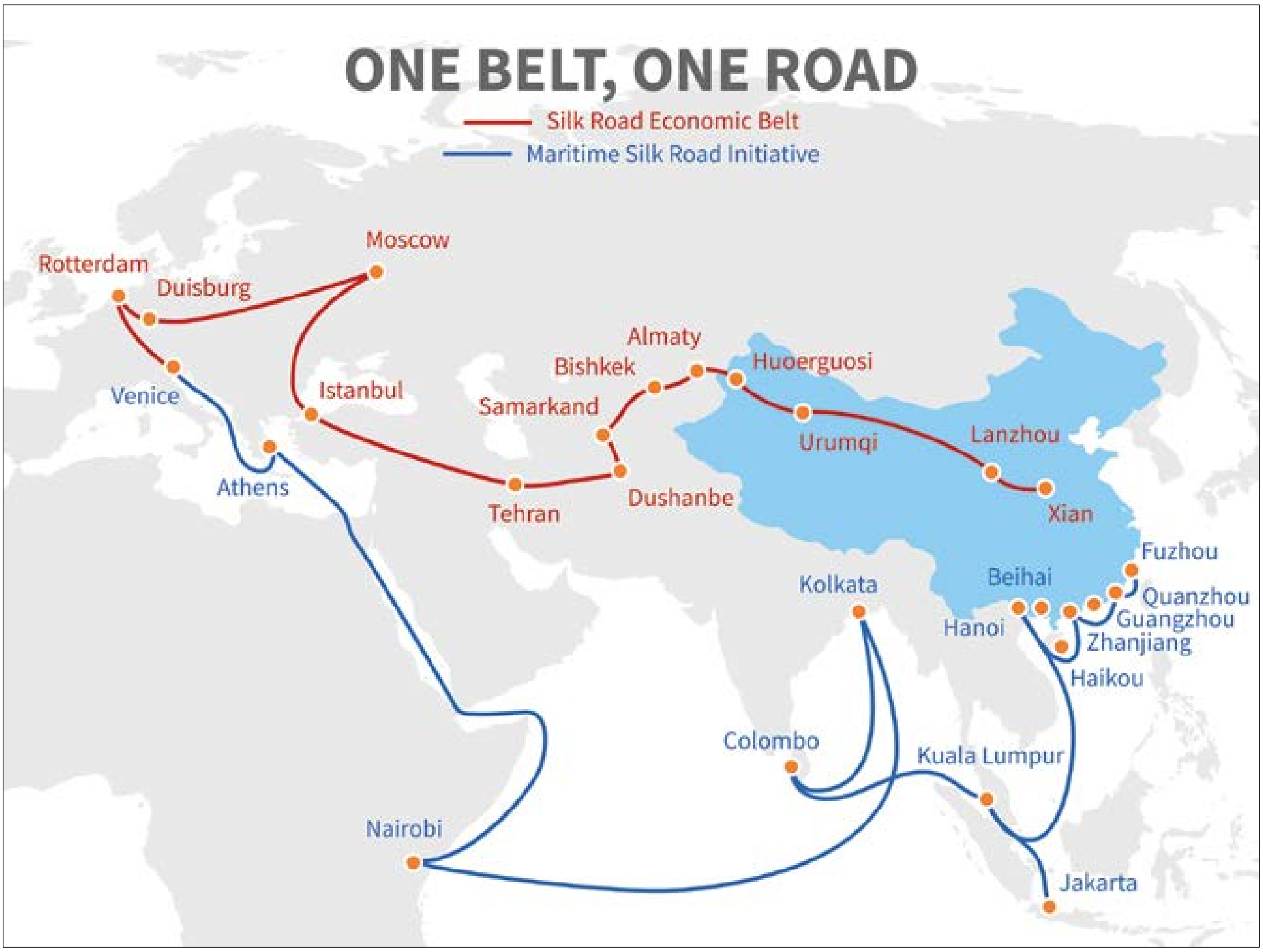
54 European Commission. (2019). *JOINT COMMUNICATION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL AND THE COUNCIL: EU-China – A strategic outlook*. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52019JC0005&qid=1627311336028.

55 Zwick, S. (2021). The notion of connectivity in the EU's economic diplomacy strategy towards the People's Republic of China (unpublished text).

56 European Commission. (2021). *EU – China Comprehensive Agreement on Investment (CAI)*. https://trade.ec.europa.eu/doclib/press/index.cfm?id=2237.

57 The European Parliament & the Council of the European Union. (2019). *REGULATION (EU) 2019/452 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union*.

As a part of re-emerging European industrial policy, the EU is planning to be granted the right to review if the companies from third countries are receiving contributions from their governments. Such subsidies are considered to be creating market distortions and companies receiving them should not be allowed to operate on the EU's market. The proposal of regulation of subsidies was issued in May 2021.



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CONCLUSION

Chinese economic diplomacy towards Europe is motivated by a wide range of interests. Most important is supporting penetration of the West European market – not only with exports of goods but also by acquisitions of logistic infrastructure and presence in public procurement. Chinese investments aim to acquire cutting edge technology and knowledge, which exists mainly in Western Europe, to help domestic economic development to graduate towards higher technologic and capital intensity and global competitiveness.

These strategic economic goals of China make it first and foremost an economic competitor for European businesses. Moreover, the Chinese companies – be it state- or private-owned alike – can rely on the type of support of the Chinese state which is not possible in the transparent free market environment of the EU. Initiatives such as the Belt and Road or Made in China 2025, and other types of preferential treatment, make it difficult for European companies to compete fairly and equally within the Chinese market, but increasingly also within the EU and the third markets.

The attempt by China to penetrate Central and Eastern Europe following the 2008 Global Financial Crisis is another challenge for European companies. The growing imports of cheap Chinese consumer goods, but even more importantly by investments and operations of Chinese firms, is threatening the historically dominant position of Western European firms in these regions. But countries of Central and Eastern Europe are direct competitors of China in production of a wide range of complex industrial goods and especially in providing labor intensive tasks within the production stage in global value chains.

The rapid economic growth of China, combined with the announced monumental foreign investment programme was considered to be a historical opportunity by many European countries. All regions of Europe would welcome Chinese investments, preferably into greenfield projects providing employment opportunities, or acquisitions of firms which could benefit from capital injections, modernisations and development. Less developed European regions were hoping to receive investments into transport, energy and IT infrastructure, which would foster the development, diversify the sources of investment and potentially decrease the dependence on the EU's economic core. To secure the investments from China, Central and Eastern European countries – but not only them – were willing to overhaul for the time being their rather reserved attitude towards China.

However, over time it became apparent that there was a fundamental difference between the Western and Chinese models of economic cooperation. While economic relations within EU are based on principles of competition, non-discrimination and transparency, interaction with China tends to work differently. The model preferred by China was to strategically invest in order to gain knowledge, market access or even political influence, with much less regard to economic rentability. Most obviously it came with the Chinese model of investment into large "BRI" projects. Here, projects were negotiated between governments, financed by loans issued by Chinese policy banks and realized by Chinese companies. This approach is rightly considered risky because it directly contradicts the principles of the functioning of the European transparent free market economy. Moreover, it is linked to debt, which is guaranteed by the governments of the countries receiving the investments. Not allowing competition also means the risk of economic inefficiency. Another problem is the environmental impact of large transport or energy projects, which would have to be examined in detail if financed (e.g.) with European funds and room for clientelism and corruption.

At the same time, interestingly, although many Central and Eastern European countries were enthusiastic about BRI at first, the attempts to realize projects within the Chinese model failed everywhere in the EU (with only one project in Hungary – the Budapest-Belgrade railway – still being potentially open, although its future remains questionable). For one, it was impossible for Chinese lending to compete with EU funds. Besides, the regime of Chinese infrastructural investment was incompatible with EU's rules on state aid, competition policy and public procurement.

Not only politically negotiated large investment projects failed to materialize, but also other kind of Chinese investments were trailing significantly behind expectations. Even when Central and Eastern European countries explicitly welcomed these investments, designated development areas, industrial parks and announced logistic hubs, the amount of Chinese investments was disappointing. How important was the firewall of European economic power, political influence and regulatory system is apparent from the very different experience of the non-EU countries in the Western Balkans, where a significant number of projects was realized following the Chinese model, posing many risks such as related to economic inefficiency, environmental damage, corruption and further reducing prospects for the EU membership of given countries.

While in the years following 2012 the China-CEE exchanges were considered by many European leaders as a threat to EU's economy and politics, most of these fears did not materialise. It soon became apparent that without a game changing amount of investment from China, the support for cooperation within the CEE region is weak. It is important to mention, that the new member countries of the EU, even if critically reconsidering some aspects of Western liberal democracy and very high levels of economic dependency on Western Europe, they still consider their membership in the EU (incl. access to single market and structural funds) and NATO to be their key vital interest. While critical to certain features of Western European developments, their distance from Eastern powers and their political system is much greater than many international observers realize – even more so, than in the case of Western Europe.

In fact, it has been Western Europe which takes the lion share of the EU-China trade as well as investment flows. Yet, the massive inflow of Chinese investments did not continue in the Western Europe either, and has decreased sharply since the peak in 2016. Also, a brief analysis of trade flows between Europe and China supports the view that a continuation of the pre-GFC China shock[58] – an epochal shift in patterns of world trade with huge adjustment costs – is unlikely. In the era of "Eastern opening" there was little change in the character of trade flows, if anything, the integration of the EU's market strengthened.

Regarding the EU's response to Chinese economic diplomacy and penetration of the European economy, we mentioned several instruments and initiatives. The FDI screening mechanism, Comprehensive Agreement on Investments (CAI) and the regulation of foreign subsidies have been some attempts of the EU to react to the Chinese assertive industrial policies. These are of the interest of all regions, but mainly the core of the European economy. Most advanced EU economies are concerned about the Chinese competition on their own market as well as markets of other member states, and they are affected by Chinese attempts to acquire and control cutting edge technologies. They are also most interested in access to the Chinese market and compete with Chinese enterprises in third markets. All these issue areas are of high importance for contemporary economic policy, and are not necessarily a reaction to Chinese economic diplomacy.

On the other hand – the Europe-Asia connectivity strategy is a direct reaction to the Chinese BRI as a key stone of its economic diplomacy. However, this part of the EU's policy reaction is the least ambitious, innovative and developed and clearly reflects the limited efficiency and impact of Chinese economic diplomacy. At the same time, the BRI itself, and Chinese economic diplomacy in the CEE region more broadly, have largely failed. The inability of China to penetrate (even) the periphery of the EU with its "China model" clearly shows the resilience of the EU. Moreover, the discussion here also raises some question marks about how significant the real-world effects of the 'flashy' economic diplomacy initiatives, including the Chinese Belt and Road Initiative or the 16+1 platform, really are. Our analysis suggests, instead, that long-term structural factors seem much stronger when facing ad hoc governments' economic diplomacy attempts, not matter how grand they may be.

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