

# COMPARATIVE ANALYSIS OF THE APPROACH TOWARDS CHINA: V4+ AND ONE BELT ONE ROAD

By Prague Security Studies Institute (PSSI)

In cooperation with:

Institute of Asian Studies (IAS), HAS Centre for Economic and Regional Studies, Institute of World Economics,  
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## INTRODUCTION

China's emergence over the last two decades as one of the world's major economies has had a transformative impact on international economic relations. Its rise as a global economic power has shifted the geographical concentration of financial capital eastward and forced firms across nearly all countries and spheres of production to compete with Chinese exporters, with often significant effects on their national economies. In 2013 China announced its "Belt and Road Initiative (BRI)", a global infrastructure project intended to link markets around the world together in a China-centric trading network, comprised of overland and sea transport routes. Practically speaking, the core strategy of the project appears to be improving market access for Chinese exporters, as well as expanding China's influence in the countries involved. But at a symbolic level the project has become a bid for rivalling the US-EU-centered global economic order.

The countries of Central Europe are expected to play an important role in the European element of the BRI strategy, given both their own expanding consumer purchasing power and the fact that they hold the key to overland routes connecting China to its largest export markets in Europe, including Germany, France, and the Netherlands. Central Europe might be perceived as a relatively underdeveloped region eager to attract new sources of growth, as well as one composed of small states with little claim to bargaining power in the face of an economic behemoth like China. This narrative would predict few obstacles to China becoming a dominant actor in the region.

The aim of this volume is to show that it is not all so simple as that. This comparative analysis of economic relations between China and the Visegrád countries + Serbia reveals that while China's role in each of their economies has grown over the last decade, developments have been anything but homogenous, and that concerns about China's impact on national security will be a critical factor in the success of the project. Using a common analytical framework across each of the chapters, these countries' relations with China are reviewed in terms of recent bilateral trade and financial data, major investment projects, and the impact of national investment screening activity. A complex overview of bilateral dynamics emerges out of this framework. The variety of results suggests that no matter the disparity between China and its partners in economic power or the financial incentives it may be able to offer, realizing the BRI is dependent on the quality of China's relations with each of the individual sovereign nations involved. Taken together, the results of this volume suggest that China cannot take anything for granted.

**Ágnes Szunomár** of the HAS Centre for Economic and Regional Studies and **Tamás Peragovics** of the Institute of Economics begin our volume with their insightful chapter on Hungary's relations with China. Hungary has arguably emerged as China's most enthusiastic partner among the Visegrád countries, but the authors point out that much of the relationship continues to hinge on decisions made by a handful of key corporations and thus the future remains difficult to predict.

**Bruno Surdel** of the Centre for International Relations (CIR) in Warsaw show the importance of modest expectations in his thorough review of Polish-Chinese relations. Initially treated with great fanfare by both governments, Poland's presumptive role as China's key Central European partner has largely failed to materialize. Disillusionment with the gains achieved so far has left Poland without a clear vision for its future dealings with China.

Bringing important perspective on BRI activity in a country in the Central and Eastern Europe region but outside of the EU, **Stefan Vladislavjev** of the Belgrade Fund for Political Excellence (BFPE) provides the details of Serbia's rapidly-evolving partnership with China. The recent rollout of high-profile investment and infrastructure projects has endeared China to the Serbian government and the public, but whether the substantial debt Serbia has incurred along the way will justify itself is yet to be seen.

The Institute for Asian Studies (IAS) gives us **Matej Šimalčík's** convincingly-argued chapter on Slovakia's cautious relations with China, which are tempered by both Bratislava's focus on continued integration with Western Europe and by its security concerns surrounding increased ties to China. This chapter's review of the significance of investment screening in this context is particularly instructive.

Finally, **Jakub Tomášek** of the Prague Security Studies Institute (PSSI) examines the state of Czech-Chinese economic relations. In-depth case studies of several Chinese firms' experiences illustrate the obstacles they face despite the Czech government's apparent support for deepening ties. The chapter emphasizes the importance of the distinction between official rhetoric and actual economic outcomes, as well as the role of negative Czech public sentiment towards Chinese business in limiting China's potential role.

Text was edited by **Zack Kramer**.

# HUNGARY

## AN ASSESSMENT OF CHINESE-HUNGARIAN ECONOMIC RELATIONS

### 1. CHINESE-HUNGARIAN TRADE RELATIONS

Over the past decade and a half, Hungary has committed itself to the development of relations with China. Budapest has become open to many types of cooperation with Beijing. Although the Hungarian political arena is rather divided, Sino-Hungarian relations enjoy a privileged position on all major parties' agendas. No matter how fierce the domestic political debates are, none of the parties question the importance of China for Hungary. Besides promoting economic relations with China, the Hungarian government has been rhetorically supporting China on many sensitive issues, such as lifting the arms embargo and granting market economy status to the country, in the context of WTO trade agreements. It has played an even more active role in the South China Sea issue and the One Belt, One Road initiative. In return, Hungary indeed occupies a disproportionately significant profile in China given its overall geopolitical importance.

The Hungarian government's desire has long been to serve as a gateway or hub for China from which to access the whole of Europe. It considers relations with China to be of great significance, where besides the development of bilateral investment and trade relations Hungary would also like to become a part of one of the main transit routes of Chinese goods targeting the European market.

Although the Hungarian Government's Eastern Opening policy<sup>1</sup> has accelerated economic relations between China and Hungary, this opening process began well before the official announcement of the strategy in 2012. For example, in 2004, the Hungarian consulate in Shanghai was reopened, and in 2010 a new consulate was opened in Chongqing. Some organizations such as the Hungarian-Chinese Economic Chamber and the Chinese-Hungarian Business Committee have been established to intensify bilateral business relations, as well. In addition, for some years Hungary has been developing its relations with China in a multilateral forum. The first China-CEE Economic and Trade Forum was held in Budapest in June 2011 and since the annual 16+1 cooperation forum was established in 2013, the Hungarian government meets with its Chinese counterparts at the highest level every year at the 16+1 summits.<sup>2</sup>

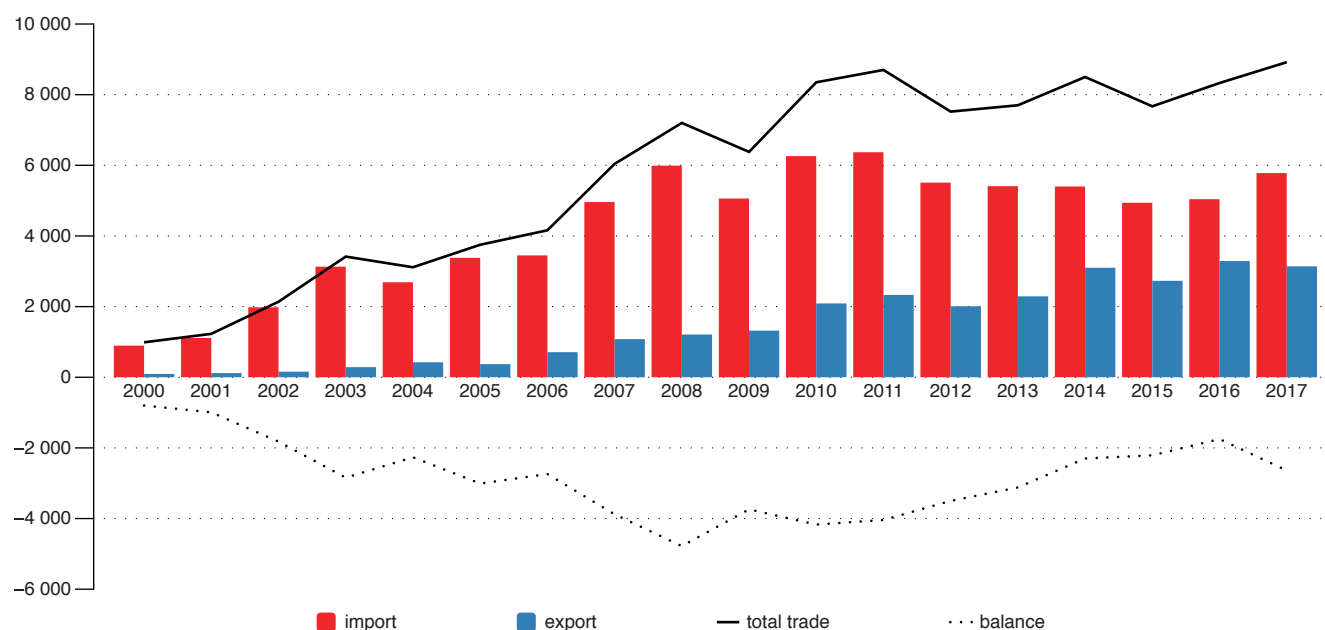
Regarding trade relations, China is one of Hungary's most important trading partners. Chinese trade volumes have steadily increased over the last one and a half decades, particularly after 2004 (Hungary's accession

date to the EU), declined slightly as a result of the financial crisis in 2008 than increased again from 2009. Although trade relations are indeed on the rise, it has to be emphasized that the vast majority (around 80%) of Hungary's export still targets the countries of the European Union, mainly Germany (25-30%) and Hungary's export to China represents less than 5% of the total. Similarly, a bit less than 80% of Hungary's imports come from the EU, with more than 25% from Germany alone, while only around 6% of imports come from China.

1 The Eastern Opening Policy's objective was to reduce the dependency of Hungary's economy on trade with the West, particularly with European Union member states, through increased commerce with countries in the East, particularly China.

2 Éltető A - Szunomár Á: Chinese investment and trade – strengthening ties with Central and Eastern Europe. INTERNATIONAL JOURNAL OF BUSINESS AND MANAGEMENT 4:(1) pp. 24-48, 2016 (available at <https://iises.net/international-journal-of-business-management/publication-detail-434>)

Figure 1. Trade between China and Hungary, 2000-2016, million USD



Source: Atlas of Economic Complexity

Certainly, the European Union has a dominant role in the trade of the CEE countries, including Hungary. The share of Asian countries is much smaller, but their role has increased during recent years: increases in trade with Asia have shown stronger growth than with the EU or other non-EU regions.<sup>3</sup> The weight of Asian trade volumes is generally more significant in imports than in exports of CEE countries, including Hungary. Asian trade dynamics are largely determined by trade with China, which has become Hungary's most important partner in Asia. In recent years, China's share in Hungary's export destinations increased but the increase is even more significant in imports.

Hungarian exports to China are partly dominated by engines since the mid-2000s, although their share in exports has been decreasing recently (the export share of engines used to be between 28 and 40% for years, but started to decrease after 2014; now it is less than 10% of exports to China). One possible reason for this decrease is that the Hungarian affiliate of the Volkswagen Group (Audi Hungaria) sharply decreased its delivery of engines to the Chinese affiliate of the VW Group. This decrease affected the total amount of Hungarian exports to China. At the same time, transport vehicles, especially cars and parts of motor vehicles, are gaining an increasing share in the export mix since 2014, and are now above 30%. Electronics (electrical transformers and other apparatus) represent the third most important export category of Hungary to China: a bit less than 15% of Hungarian export comes from this category.

In the past few years the export of agricultural products to China gained a certain impetus. Chinese authorities usually undertake a long period

for examination before allowing such products into the Chinese market. Hungary received permission to export beef (being the first in the EU, although there is no significant delivery so far) and milk products (being third after Poland and Bulgaria) and more and more firms are permitted to export pork too.

On the import side, the leading product group for several CEE countries is electronics, mainly telecommunication equipment (telephones, transmission apparatus and relating spare parts). This is also the most significant product category for Hungarian imports from China, taking up 60-70% of the total for several years. In recent years it is between 50-55%. The second most important product category is machinery, especially LCD televisions and computers, taking up to around 25% in recent years.

The pattern of trade between China and CEE has changed somewhat in the last decade. In certain cases, volumes increased and in other areas they decreased. These structural changes generally resulted in the increase share of high-tech goods in trade in certain CEE countries. The volume and overall share of high-tech exports to China has been the highest in the case of Hungary. In general, the CEE-China trade is much more high-tech intensive than the CEE-EU trade.<sup>4</sup>

The high technology intensity of trade is mainly due to the aforementioned large flows of automotive, electronics and telecommunications products. This is based on the activity of multinational companies in the global production networks.<sup>5</sup> The bulk of foreign trade between Hungary and China has been and still can be traced to certain products and certain

3 Éltető A - Toporowski, P: Global value chains - shaping trade between Visegrad Countries and Asia. Europe-Asia Studies, 2013 (available at [www.etsg.org/etsg2013/Papers/297.pdf](http://www.etsg.org/etsg2013/Papers/297.pdf))

4 Éltető, A - Szunomár Á: Trade and investment between the Visegrad and East Asian countries with a special emphasis on China and Hungary. In: Antal J (ed.) Small states - big challenges: the experience of the EU and Visegrad region. Prague: Nakladatelství Oeconomica, 2015. pp. 79-95.

5 Éltető A - Toporowski, P: Global value chains - shaping trade between Visegrad Countries and Asia. Europe-Asia Studies, 2013 (available at [www.etsg.org/etsg2013/Papers/297.pdf](http://www.etsg.org/etsg2013/Papers/297.pdf))

(multinational) companies. Because the volume of trade is relatively small (compared to for example trade with the EU or specifically Germany), one decision of a global company concerning relocation or change in internal deliveries among affiliates can significantly change the trade volumes

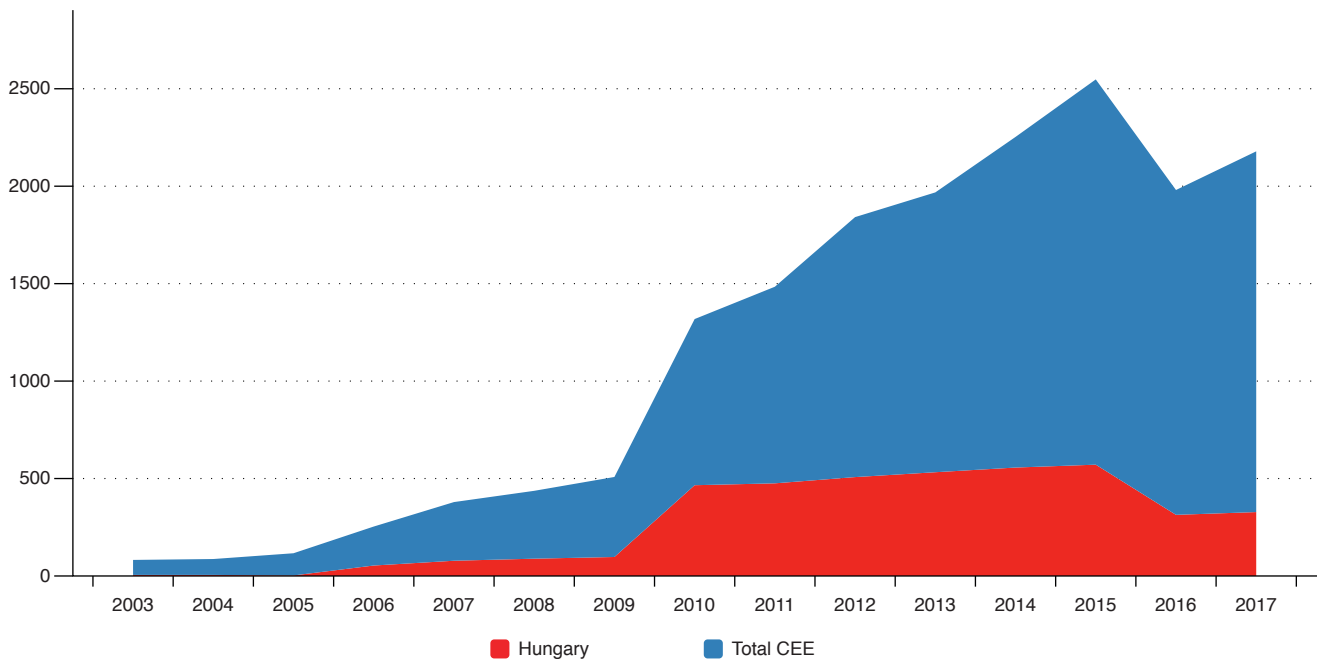
of a given country vis-à-vis China. Relocating plants from Hungary, for example, decreased Hungarian export capacity to Asia significantly in 2012-13.

## 2. CHINESE-HUNGARIAN INVESTMENT RELATIONS

Hungary's Eastern opening policy doesn't concentrate only on developing trade relations and economic opportunities but also on attracting investment from emerging Asian countries, of which China is considered to be an investor of growing importance. The role of Chinese capital in Hungary compared with the total amount of invested capital is still very small, but in the last few years these capital inflows have accelerated significantly.

Chinese investment in Hungary started to increase after the country joined the EU in 2004. According to Chinese statistics, a truly rapid increase occurred, from 0.65 million US dollars in investments in 2005 to 370.1 million US dollars in 2010. In 2010, Hungary itself took 89% of total Chinese capital flow to the CEE region, and around half of the stock.<sup>6</sup>

Figure 2. China's OFDI stock in CEE, including Hungary, 2003-2017, million USD, Chinese statistics



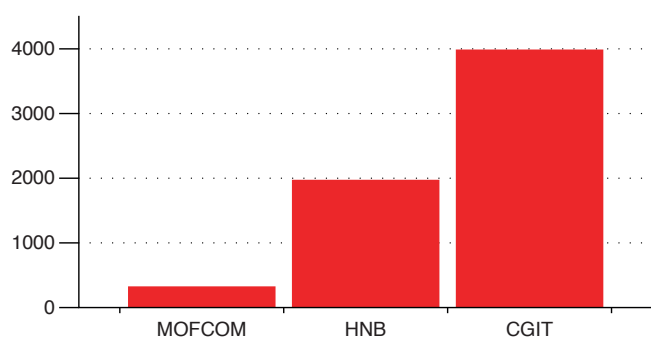
Source: MOFCOM

Nevertheless, this amount is far greater than in the graph above, when taking those statistics into consideration that traced the chains of ownership of the companies investing, since a significant portion of Chinese investment is received via intermediary countries or companies, and therefore appears elsewhere in Chinese statistics. According to the Hungarian National Bank's statistics, Chinese investment stock in Hungary was about 1,8 billion USD by 2017, while China Global Investment Tracker,

a database owned by the Heritage Foundation, cites an even higher figure: 4 billion USD in investment stock.

6 Chen X: Trade and economic cooperation between China and CEE countries. Working Paper Series on European studies, Institute of European Studies, Chinese Academy of Social Sciences, Vol. 6, No. 2., 2012

Figure 3. China's OFDI stock in Hungary, 2003-2017, million USD, comparing statistics



Source: MOFCOM/Hungarian National Bank/China Global Investment Tracker

Chinese investors typically target secondary and tertiary sectors in Hungary. Initially, Chinese investment has flowed mostly into manufacturing (specifically assembly), but over time services have attracted more and more investment too. For example, there are now branches of Bank of China and Industrial and Commercial Bank of China, as well as offices of some of the largest law firms in China, Yingke Law Firm (since 2010) and Dacheng Law Offices (since 2012). The major Chinese investors targeting the country are primarily interested in telecommunication, electronics, chemical industry, transportation and energy markets.

## MAIN INVESTMENT TRENDS AND PROJECTS

Although Chinese multinational companies represent a relatively small share of total FDI stock in Hungary, they have saved and/or created jobs and contributed to the economic growth of Hungary with their investments and exports during recent years. Furthermore, many of them (e.g. Lenovo, ZTE, Huawei, Bank of China) have turned their Hungarian businesses into European regional hubs of their activities.<sup>7</sup>

Table 1. Chinese FDI in Hungary - major characteristics

Main form of investment	Greenfield / brownfield, M&A, joint ventures
Main sectors	Chemical, IT / ICT, electronics, wholesale and retail, automotive, banking, hotels and catering, logistics, real estate
Most important Chinese companies	Wanhua, Huawei, ZTE, Lenovo, Sevenstar Electronics, BYD Electronics, ZMJ, Comlink, Yanfeng, China-CEE Fund
Company form of investors	both state-owned and private
Preferred locations	Central Hungary, Northern Hungary
Employees	from 350 to 3000 per branch

Source: own compilation

A major part of China's FDI stock in Hungary originates from an investment made by the Chinese chemical company Wanhua, which acquired a 96% stake in the Hungarian chemical company BorsodChem through its Luxembourg subsidiary in 2011. This subsidiary also later made additional investments for the development of BorsodChem. It is the largest Chinese investment in CEE so far. This acquisition positioned Wanhua as one of the major producers of raw materials in the automotive, insulation, construction and furniture sectors. In addition, this investment was also an important sign that Wanhua had chosen Hungary as its regional headquarters.

In addition to Wanhua's acquisition, additional important acquisitions have taken place over the past few years which affected Hungary as a result of foreign firms having branches already located in the country: at the end of 2017 Zhengzhou Coal Mining Machinery Group purchased Bosch's SEG Automotive Germany GmbH, the former Robert Bosch Starter Motors Generators Holding GmbH, while in late 2016 Midea acquired German KUKA with its foreign subsidiaries. Lexmark International Technology was also acquired by Chinese companies Apex Technology and PAG Asia Capital in 2016.

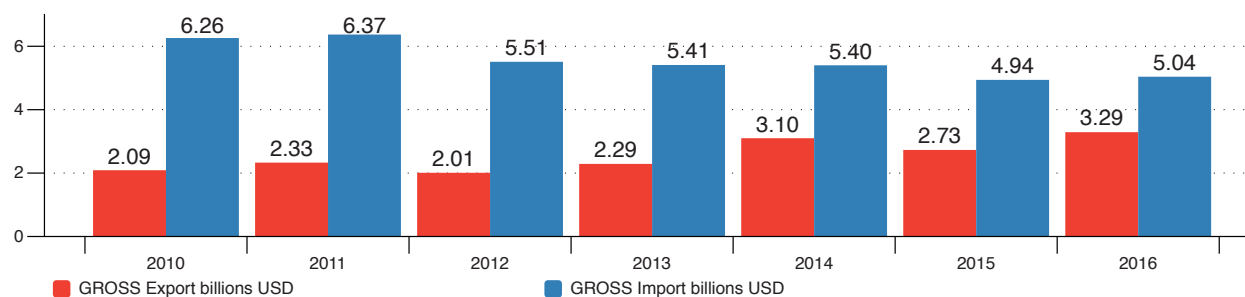
The second biggest Chinese investor in Hungary, and the biggest among Chinese greenfield investors, Huawei, arrived in the country in 2005, while its European Supply Centre started its operations in 2009. The Centre is Huawei's second biggest supply chain in the world and it serves as a production and logistics centre for 55 countries in Europe, North and West Africa, Russia, Central Asia and the Middle East. The company employs around 330 people directly (white-collar workers) out of whom 60% are Hungarian and the rest are Chinese nationals (on Hungarian work permits). But indirectly (as several activities are outsourced to other companies), Huawei Hungary is also responsible for 2500-2700 employees (blue-collar workers at Foxconn, Flextronics, DHL, etc.), which is around 3000 jobs in total. It has two factory units (assembly) in Komárom and Pécs, and a logistics centre in Biatorbágy. Huawei is the second largest Chinese investor in Hungary (after Wanhua), which serves all the top mobile operators (including Telenor, Vodafone, Deutsche Telekom) in the country, that is, actually 70% of Hungarian people. Huawei engages in various initiatives, such as talent development programmes as well as establishing cooperation with universities.

Besides being a potential hub for Chinese products in the European Union, Chinese companies expressed their interest in several Hungarian infrastructure-related investment in recent years, such as plans to transform Szombathely airport into a major European cargo base or develop the infrastructure of the Debrecen airport. None of them have been realized so far. The project to modernize the Belgrade-Budapest railway is a recent example of this kind, planned under a new framework, China's Belt and Road initiative. However, this hasn't been realized yet, either, since it was delayed by the European Commission because of transparency issues and questioned for its price/quality ratio domestically, too.

<sup>7</sup> Szunomár, A; Völgyi K; Matura, T: Chinese investments and financial engagement in Hungary. Working Paper Nr. 208., Institute of World Economics, Centre for Economic and Regional Studies, Hungarian Academy of Sciences, 2014 (available at: <http://vki.hu/wp-208.pdf>)



Figure 4. Hungary - China trade



Source: ATLAS OF ECONOMIC COMPLEXITY (AEC)

### 3. FOREIGN INVESTMENT SCREENING IN HUNGARY

As Chinese companies' investments are likely to continue in the future, CEE countries are facing a dilemma between encouraging and welcoming it, on the one hand, and safeguarding strategic sectors and industries of their national economies, on the other. In the European Union, only 14 of the 28 member states, mostly Western European countries, have any kind of national investment screening mechanism in place for the sake of allowing governments to attempt a balance between these two considerations. Since these mechanisms reflect national characteristics and vary significantly in scope and design, the European Commission put forward a proposal in September 2017 to regulate the matter more systematically by establishing a collective screening framework,<sup>8</sup> providing oversight for investment projects or programs "of Union interest."<sup>9</sup> While official documents do not single out Chinese companies to justify the need for such protective regulation, the EU's concerns and suspicions about Chinese investors nonetheless provide an important rationale for an effective Union-wide investment screening mechanism.<sup>10</sup>

In this European context, the Hungarian government has passed a bill in parliament to establish a national investment screening procedure, which came into effect 1 January 2019. Act LVII of 2018 on the supervision of foreign investments violating the national security interests of Hungary introduces a mandatory review process and conditions the acquisition of stakes by foreign entities in strategically sensitive businesses upon prior approval by the relevant minister designated by government decree.<sup>11</sup> The threshold for the size of the foreign stake at which the investment must be announced is 25% in the case of any Hungarian company, and 10% in the

case of publicly listed Hungarian companies. In addition, if an acquisition by a foreign entity were to result in decisive or overwhelming influence, as stipulated by the Hungarian civil code, the investment is likewise subject to the same procedure. Economic activities under the protection of the act include the armaments and defence industry, the production of dual-use goods, the financial services industry and the banking sector, the energy industry, water utilities, as well as information technology.

Upon receiving the notification of the foreign entity, the designated minister has 60 days to conduct an investigation in order to identify the ownership structure and assess the effects and implications of the planned investment. If extraordinary circumstances require, the 60-day period can be extended by an additional 60 days, potentially lengthening the review process to 120 days. Ultimately, the minister decides on the basis of whether or not the investment infringes upon Hungary's security interests. In the case of a rejection, the foreign entity can appeal against it at the Budapest-Capital Regional Court. However, the grounds upon which the appeal can be made are strictly procedural, and the court cannot overturn the decision but can only require the minister to conduct the review process again. A failure to notify the minister in advance of the planned investment and to comply with the legal requirements of the screening mechanism can lead to a penalty of HUF 10 million, to be paid by the foreign entity.

While the exact consequences of the act are still difficult to foresee, some of its implications are clear. Hungary is at the forefront of expanding and

<sup>8</sup> "Proposal for establishing a framework for screening of foreign direct investments into the European Union"; European Commission; 13.09.2017 (available at [https://eur-lex.europa.eu/resource.html?uri=cellar:cf655d2a-9858-11e7-b92d-01aa75ed71a1.0001.02/DOC\\_1&format=PDF](https://eur-lex.europa.eu/resource.html?uri=cellar:cf655d2a-9858-11e7-b92d-01aa75ed71a1.0001.02/DOC_1&format=PDF))

<sup>9</sup> "EU Framework for FDI screening"; *European Parliament*; February 2019 (available at [http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/614667/EPRS\\_BRI\(2018\)614667\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2018/614667/EPRS_BRI(2018)614667_EN.pdf))

<sup>10</sup> Brattberg, Erik, Soula, Etinne: "Is Europe Finally Pushing Back on Chinese Investments?"; *The Diplomat*; 14.09.2018 (available at <https://thediplomat.com/2018/09/is-europe-finally-pushing-back-on-chinese-investments/>)

<sup>11</sup> The full and up-to-date text of the act is available in Hungarian at: <https://net.jogtar.hu/jogszabaly?docid=A1800057.TV&timeshift=fffff4&txrefrerer=00000001.TXT> (accessed 28 October 2018).



strengthening cooperation with China in the CEE region, yet foreign direct investment from Chinese companies is a modest 2.4% of the total FDI stock in Hungary.<sup>12</sup> EU partners still dominate the Hungarian economy, with German investments amounting to roughly 25% of the total. It was only on 28 October 2018, at a meeting between the Prime Minister of Japan and his counterparts from the Visegrad 4 countries, that the Hungarian PM made clear that cultivating good relations with China is a priority in Hungarian foreign policy. In something of a diplomatic fiasco, the Hungarian side was unwilling to support a joint statement with critical references to China's behaviour in the South China Sea, leading to a more neutrally-phrased version of the document that the Japanese side decided not to sign.<sup>13</sup> The diplomatic charm offensive towards Beijing means that the new Hungarian screening mechanism is decidedly not meant to discourage Chinese companies from investing in the country.

In recent years, the Hungarian government has embraced a protectionist and interventionist market attitude with the purpose of reducing foreign ownership in crucial economic sectors. Two notable examples are the banking sector, where allegedly excessive profits warranted the government's intervention, and restrictions on the foreign purchasing of Hungarian farmland.<sup>14</sup> The act on the supervision of foreign investments makes it possible for the government to expand its discretionary power over other areas of strategic significance. The review process conducted at the ministerial level means that the decision will be influenced by high political considerations, whereby factors other than national security are expected to affect the outcome. The lack of transparency and a clear definition of what constitutes an inviolable security interest for Hungary also inevitably exposes the process to the political preferences of the government.<sup>15</sup> Ironically, even if shady ownership chains of foreign companies are often used to explain the need for a national screening mechanism, the very process by which they are disentangled and revealed does not promise to be any more transparent. It is also noteworthy that

certain activities enumerated in the act have long already been tied to prior government approval, even if only at the level of the relevant national regulator rather than the minister.

The Hungarian act also differs from the European Commission's proposal in a few important ways. The EC proposal emphasizes transparency, non-discrimination and predictability as three key principles underlying the screening process. As much as the screening mechanism is intended to protect key economic sectors, it should also work to alleviate fears of foreign investors that the EU is no longer open for business. Furthermore, the proposal complements ordinary security considerations by adding a reference to public order, expanding the grounds upon which a particular investment plan must be screened. While the EU prides itself on being one of the "most open investment regimes," third countries also often do not reciprocate by providing similar access to their markets for European investors. This state of affairs is clearly detrimental to the European Union, so the proposal appears to be a warning and an intervention against such unfair market access practices. While the Hungarian act does not concern itself with these considerations, it should be kept in mind that the screening mechanism at the level of the EU would work in tandem with those of the member states. The EU would essentially rely on member state reports about the outcome of a particular screening process, and the contribution of other member states and the Commission would be limited to issuing comments and opinions about the process. Ultimately, the right of decision about giving the green light to a particular project would still reside in the capital of the member state where the investment is planned. It should be noted that even though the proposal was approved on 28 May 2018 by the EP's International Trade Committee,<sup>16</sup> it has yet to take its final shape and therefore remains subject to changes. To our knowledge, the Hungarian government has yet to adopt an official position with regards to the EU's proposal.

## 4. CONCLUSION

Within the CEE region, Hungary's relations with China have been unique in several ways. They are unique in a historic sense, since Hungary was one of the first countries to formally recognize China, and the Hungarian government started to re-establish relations with China in the early 2000s, well before the other CEE countries. Furthermore, they are unique in a political sense, since Hungarian governments, regardless of political

orientation, have been working on developing relations with China for almost two decades, and Hungary was the first in the CEE region to adopt an official government strategy towards Asia (and China specifically): its "Eastern Opening policy". Lastly, they are unique in the sense that Hungary is the destination of the majority of Chinese foreign direct investment

12 Szunomár, Ágnes; "Chinese economic influence in Hungary – Rhetoric versus realities"; *Institute of World Economics Blog*, 20.09.2018 (available at [https://vilaggazdasagi.blog.hu/2018/09/20/chinese\\_economic\\_influence\\_in\\_hungary\\_rhetoric\\_versus\\_realities](https://vilaggazdasagi.blog.hu/2018/09/20/chinese_economic_influence_in_hungary_rhetoric_versus_realities))

13 "Orbán miatt diplomáciai fiaskóval ért véget a V4–Japán miniszterelnöki találkozó"; *Index*; 24.10.2018 (available at [https://index.hu/kulfold/2018/10/24/kina\\_orban\\_japan\\_v4-ek\\_diplomaciai\\_fiasco/](https://index.hu/kulfold/2018/10/24/kina_orban_japan_v4-ek_diplomaciai_fiasco/))

14 "Hungary Openness to Foreign Investment"; *Export.gov*; (available at <https://www.export.gov/article?id=Hungary-Openness-to-Foreign-Investment>)

15 "Vajon hatékony lesz a külföldi befektetések ellenőrzése?"; 15.07.2018 (available at <https://arsboni.hu/vajon-hatekony-lesz-a-kulfoldi-befektetesek-ellenorzese/>)

16 "Foreign investment to be screened to protect EU countries' strategic interests"; *European Parliament*; 28.05.2018 (available at <http://www.europarl.europa.eu/news/en/press-room/20180528IPR04446/foreign-investment-to-be-screened-to-protect-eu-countries-strategic-interests>)

(FDI) in the region, whilst serving as a regional hub for several Chinese companies and hosting the biggest Chinese population in CEE.

Indeed, Hungary has achieved good results in its economic relations with China over the past decade. Nonetheless, some successful deals have led to further – sometimes excessive – expectations, for example over Chinese involvement in infrastructure development.

When searching for possible factors that make Hungary a favourable investment destination for China, the cost and quality of labour is to be considered first: a skilled labour force is available in sectors for which Chinese interest is growing, while labour costs are lower in Hungary than the EU average. In addition to the traditional macroeconomic factors, institutions also play a role. An interesting aspect that is inducing investments in CEE is institutional stability (e.g. protection of property rights), which is in line with the findings of Clegg and Voss,<sup>17</sup> who argue that Chinese OFDI in the EU shows “an institutional arbitrage strategy” as “Chinese firms invest in localities that offer clearer, more transparent and stable institutional environments”. The role of state subsidies and incentives should be also mentioned here as a potential factor of attraction for Chinese FDI. Especially before EU membership, but also afterwards, governments and local authorities applied sometimes tailor-made incentives to attract large investors, such as customs free zones or special economic zones with support services, tax allowances, partial funding for employee training or residence visas.<sup>18</sup>

Moreover, Hungary’s Chinese diaspora, which is an acknowledged attraction for Chinese FDI in the extant literature,<sup>19</sup> is the largest among CEE countries. As a result, Hungary received relatively large amounts of FDI over the past decade and a half, and these investment flows started earlier than for others in CEE. Compared to other investors in the region, Chinese companies also seem to pay more attention to the level of political relations; political gestures and measures are still important in developing relations with China. Hungary, which is one of the major recipients of Chinese OFDI in the CEE region, has had historically good political relations with China, and they started earlier than in other CEE countries of the political relation.

The Hungarian national investment screening act is part of a broader European tendency in which the protection of sensitive industries and sectors is increasingly deemed to warrant a specific legal instrument in the form of investment screening. Making sure that much-needed foreign direct investment is not scared away, the Hungarian government will have to walk a fine line between prioritizing security considerations and those of the country’s economic and financial needs. The adoption of the act on the supervision of foreign investments is an important first step, even if the review process it establishes may suffer from a number of shortcomings. The lack of transparency, the role of the minister as chief arbiter, and the absence of objective criteria for interpreting national security interests,

not to mention the potential loopholes yet to be discovered, all point in the direction of a highly politicized process whereby larger political and diplomatic considerations may easily overwhelm other concerns. On the other hand, the Hungarian government’s pro-Chinese foreign policy, as well as the Eastern Opening agenda, create the impression that the act itself was not adopted to counter or restrain China’s growing economic footprint in the CEE region. Therefore, the Hungarian act may prove to be an exception to the growing sentiment in Europe that the single biggest threat to our most vulnerable businesses comes from China.

17 Clegg J - Voss H: Chinese overseas direct investment in the European Union, Chatham House Publications, 2012 (available at [http://www.chathamhouse.org/sites/default/files/public/Research/Asia/0912ecran\\_cleg\\_gvoss.pdf](http://www.chathamhouse.org/sites/default/files/public/Research/Asia/0912ecran_cleg_gvoss.pdf))

18 Hungary is the only country in the region that introduced special incentive for foreign investors from outside the EU, which is a possibility to receive a residence visa when fulfilling the requirement of a certain level of investment in Hungary (300000 EUR)

19 Buckley Pet al.: The Determinants of Chinese outward foreign direct investment”, in; Voss, Hinrich; and Zhen, Ping (2007) Journal of International Business Studies, 38, pp. 499-518.

## POLAND

### CHINESE INVESTMENTS IN POLAND. NO EXPANSION ON THE HORIZON.

#### 1. STRATEGIC AND ECONOMIC ENVIRONMENT

Poland, the largest economy in Central and Eastern Europe, and a member of the European Union with access to its common market, as well as a country boasting a convenient geographical location on the mainland route from China to Germany and Western Europe, has long envisioned itself as an attractive investment location for Asian economic powers. The political, institutional, and economic stability of the country and its legal security (e.g. protection of intellectual property) have been considered a great asset. In addition, relatively low labor costs and the high qualifications of Polish employees (compared to Western Europe) seem to favour Chinese Foreign Direct Investments (FDI) in the country.

On the Polish side, the country needs to expand and upgrade its infrastructure and would wish to attract funding from Asia to those sectors of its economy where cooperation is not possible with business entities from Western Europe or as part of European Union funds, especially highly-valued "greenfield" and "brownfield" projects.

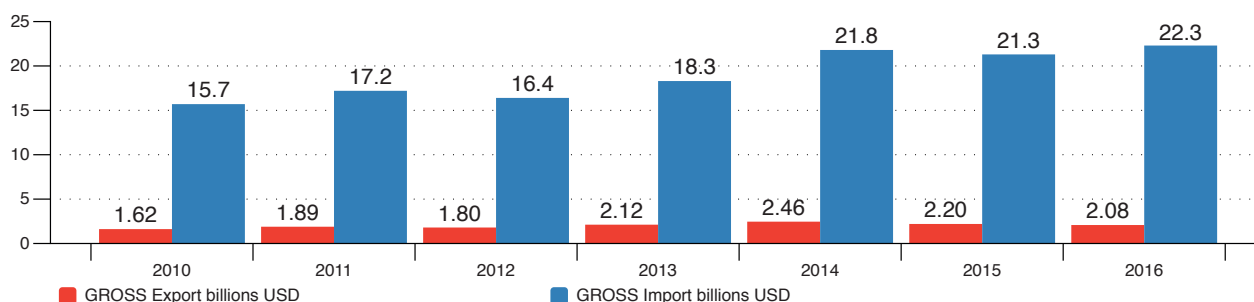
Sino-Polish ties gained momentum in 2011 with the Poland - China Strategic Partnership agreement signed in Beijing by Polish President Bronisław Komorowski and Chinese President Hu Jintao. After years of relative stagnation, this was hailed as a new beginning for Polish-Chinese bilateral contacts, which was confirmed in April, 2012 with the historic visit of Chinese Premier Wen Jiabao to Warsaw. It was precisely this visit that brought new prospects of enhanced economic cooperation, and also raised high expectations both in Poland and in other Central and Eastern European countries. Critical for the Polish leadership, the Polish capital city of Warsaw was chosen by their Chinese guest to announce a new initiative, known as the "16+1" format: China-Central and Eastern Europe Cooperation. Poland was one of the first nations in Central-Eastern Europe (CEE) to upgrade its relationship with China to the level of a strategic partnership. Therefore Poland, like other members of the Visegrad Group and CEE more broadly, had hoped to receive a decent share of Chinese investments under the new, massive Belt and Route initiative (BRI) announced by President Xi Jinping in 2013.

Poland tried to give new impetus to the freshly-minted relationship in November, 2015 when the new Polish President Andrzej Duda presided over an official state delegation to China for the annual CEE - China (16+1) summit. This was a highly significant event, as prime ministers routinely attend these meetings. The Polish president opened a Sino-Polish Economic Forum in Shanghai on 23 November, 2015, where he brought nearly 80 Polish companies from the chemical, pharmaceutical, energy, aerospace and infrastructure sectors as well as telecommunications, finance, banking, IT, mining, food processing and green technologies.

President Duda was sworn into office in August 2015, and one of his first official acts was paying a visit to Beijing. During that visit he expressed a strong hope that the five years of his presidency would be a period of great intensification of cooperation between the two countries. In fact, Polish authorities and the business community seemed to wish that Poland would become one of the main Chinese partners in Central Europe within the framework of the BRI, and to better use Poland's geographical potential as a country capable of connecting China with the West. The Polish Government's endeavour had paid off as of June, 2016, as the PRC's president Xi Jinping visited Poland and both nations promoted their ties to a Comprehensive Strategic Partnership. Warsaw built on that momentum and in May, 2017, Prime Minister Beata Szydło attended the Belt and Road Forum for International Cooperation in Beijing.

In general, 2015-2017 was a period of high-level political exchange, and in 2016, Poland joined the AIIB - Asian Infrastructure Investment Bank as one of its founding members. However, by 2018 the situation had changed; at the 16+1 summit in Sofia, Poland was represented by Deputy Prime Minister Jarosław Gowin instead of Prime Minister Mateusz Morawiecki. Poland's narrative is that since the inception of the 16+1 format in 2012, it's been one of its most active stakeholders. However, the prevailing understanding is that the initiative has not brought enough concrete results, and has not translated into the development of closer mutual relations between Poland and China. Therefore, it is the bilateral relationship and not the 16 + 1 format that remains a priority.

Figure 5. Poland – China trade



Source: ATLAS OF ECONOMIC COMPLEXITY (AEC)

## 2. POLAND – CHINA TRADE

The huge imbalance in bilateral Sino-Polish trade has been growing rapidly over the course of recent years; Poland's export:import ratio with China was 1:12 in 2018, according to Prime Minister Morawiecki's assessments that year, though there is no consensus as to the exact number, nor whether the trade deficit is really unfavorable for Poland's economy or not.<sup>20</sup> Interestingly, despite the mentioned imbalance, Poland's overall trade deficit is not that large and amounted to approximately 5.8 billion USD in 2018.<sup>21</sup>

Polish imports from China have been increasing steadily since 2011, when they reached 13.8 billion USD. In 2013, following the launch of the 16+1 format they rose to 15.2 billion USD, and in 2014 – 17.9 billion USD. A figure of 18.2 billion USD was achieved in 2016.<sup>22</sup> Poland's exports, however, have not followed suit, instead remaining both relatively low and stagnant between 2011 and 2016. In 2011, Poland exported goods to China worth 1.80 billion USD; in 2013 exports modestly increased to 2.01 billion USD, 2014 reached 2.30 billion USD, but in 2016 the value of exports decreased to 1.90 billion USD.<sup>23</sup> Therefore, the large trade deficit with Beijing isn't expected to be balanced any time soon.

The structure of Sino-Polish trade has never been favourable for Poland, as the largest share is made up of raw commodity exports like copper (42.53

% in 2011, and 20.81 % in 2016).<sup>24</sup> Pork exports reached 1.07 % in 2012 and grew significantly after the visit of the Chinese Premier Wen Jiabao, amounting to 4.42% of the total in 2013; but decreased dramatically the following year to just 0.98% and were then discontinued altogether as Chinese authorities imposed a ban on Polish pork due to detected cases of African Swine Fever (ASF).<sup>25</sup> Poultry exports achieved 1.71 % of the total in 2016. Meanwhile, imports from China include computers (9.66 % in 2011, and 10.67 % in 2016), as well as a growing volume of telephones (3.70 % in 2011, and 5.22 % in 2016).<sup>26</sup>

Lack of expertise on the Polish side, and bureaucratic hurdles on the Chinese side, have always been a serious barrier to more dynamic exports from Poland. It has also contributed to the abovementioned trade imbalance between the two countries which – for its part – decreased Polish enthusiasm for deeper involvement in the 16+1 format and initial hopes associated with the BRI.

As such, discussion about the 16 + 1 format has quieted. In any case, Poland is located "at the end" of the BRI and apparently, 'too many' countries compete with it as claimed by some interviewed politicians. In the Baltic countries, these are primarily Lithuanian ports; outside the EU, Russian

<sup>20</sup> "Morawiecki: Połexit jest tak samo możliwy jak Germanexit. Polska jest i pozostanie częścią UE"; *Forsal*; 28.01.2018 (available at <https://forsal.pl/gospodarka/polityka/artyku-ly/1100697,morawiecki-połexit-jest-tak-samo-możliwy-jak-germanexit.html>)

<sup>21</sup> "Deficyt w obrotach towarowych handlu zagranicznego w 2018 r. wyniósł 5,1 mld euro – GUS"; *Pap biznes*; February 2019 (available at <http://biznes.pap.pl/pl/news/pap/info/2677361,deficyt-w-obrotach-towarowych-handlu-zagranicznego-w-2018-r-wyniosl-5-1-mld-euro--gus>)

<sup>22</sup> „The Atlas of Economic Complexity”; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/?country=177&partner=undefined&product=undefined&productClass=HS&startYear=undefined&target=Product&tradeDirection=import&year=2016>); (retrieved 8 February, 2019).

<sup>23</sup> „The Atlas of Economic Complexity”; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/?country=177&partner=undefined&product=undefined&productClass=HS&startYear=undefined&target=Product&year=2016>); (retrieved 8 February, 2019).

<sup>24</sup> „The Atlas of Economic Complexity”; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/?country=177&partner=undefined&product=undefined&productClass=HS&startYear=undefined&target=Product&year=2016>); (retrieved February 8, 2019).

<sup>25</sup> "Chiny wstrzymały import wieprzowiny z Polski"; *POLSUS*; 04.03.2014 (available at <https://polsus.pl/index.php/aktualnosci-i-ogloszenia/3610-chiny-wstrzymaly-import-wieprzowiny-z-polski>)

<sup>26</sup> „The Atlas of Economic Complexity”; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/?country=177&partner=undefined&product=undefined&productClass=HS&startYear=undefined&target=Product&tradeDirection=import&year=2016>); (retrieved 8 February, 2019).

ports. And in the EU's south, the Greek port at Piraeus has potential to become an alternative to the Baltic countries. In addition, the Polish Three-Sea initiative may be perceived by the Chinese as an obstacle to the 16+1 structure. The Three Sea is a cooperation forum of 12 countries: Austria, Bulgaria, Croatia, the Czech Republic, Estonia, Lithuania, Latvia, Poland, Romania, Slovakia, Slovenia and Hungary. According to Polish Ministry

of Foreign Affairs, the initiative is aimed at "strengthening links in the wider Central European region (between the Baltic, Adriatic and Black Seas), creating sustainable foundations for economic development in the areas of energy, transport, digital communications and the economy". Its priority is "to build a coherent and well-integrated infrastructure in Central Europe".<sup>27</sup>

### 3. CHINESE INVESTMENTS IN POLAND

#### SUMMARY

Chinese financial institutions in Poland include: Bank of China, China Construction Bank, Industrial and Commercial Bank of China (ICBC) as well as Haitong, all of which have been facilitating Chinese business and trade activity in Poland. The same can be said about the Dacheng Law and Yingke Law firms that opened offices in Poland in 2011 and 2012, respectively.

Over the years, the nature of Chinese investment in Poland has evolved. There has been a robust presence of the IT industry (Huawei, ZTE), electronics (TCL Corporation - production of LCD TVs and monitors), electromechanics (Nuctech Warsaw), metallurgy (Dong Yun), machine production (LiuGong Machinery, Tri-Ring Group), chemicals and electro-chemicals (Petrochemia Blachowonia SA, Guotai-Huarong Poland), meat processing (Smithfield, purchased by Shuanghui International Holdings) and distribution (GD Poland).

As Chinese authorities see the future in development and expansion of new technologies, services and renewable energy, this focus is in a way reflected in Poland, where in 2016 China Everbright International acquired Novago, which deals, among other things, with municipal waste processing, recycling and the production of alternative fuels. Moreover, in December 2015, a fund controlled by China Three Gorges Corporation has bought a 49% stake in wind farms in Poland from the Portuguese firm EDPR.<sup>28</sup> The Chinese companies involved in the construction of electronic infrastructure are Pinggao Group and Sinohydro Corporation.<sup>29</sup> In the real estate industry, the key player is China Invest Corporation. It is possible that the Central Communication Port might be built with some participation from Chinese investors, and the same applies to projects for the restoration of navigability to rivers in Poland.<sup>30</sup> The Central Communication Port (CPK) is a Polish megaproject intended to become an international transport hub

based on integrated air and rail nodes. The CPK is planned to be opened in 2027.<sup>31</sup>

Table 1. Chinese FDI in Poland: major characteristics

Main form of investment	M&A, greenfield/brownfield
Main sectors	ICT, electronics, electromechanics, metallurgy, machine manufacturing, aviation industry, chemicals and electro-chemicals, distribution, food industry, renewable energy, environment / bio-fuels, electric infrastructure, real estate, logistics, hospitality, banking.
Most important Chinese companies	Huawei, ZTE, TCL Corporation, Nuctech Warsaw, Tri-Ring Group, Dong Yun, Guotai-Huarong Poland, Shuanghui International Holdings, GD Poland, China Everbright International/ Novago, China Three Gorges Corporation, Pinggao Group, Sinohydro Corporation, Shanghai Electric Power Construction, Fabryka Łożysk Toczących-Kraśnik S.A. (Rolling Bearings Factory), Suzhou Chunxing Precision Mechanical, WH Group/Pini Polska, Hamburger Pini, Royal Chicken; Jiangsu Olive Sensors High-Tech, LiuGong Dressta Machinery, Hongbo Clean Energy Europe, China Investment Corporation/ Logikor, SDIC Zhonglu Fruit Juice/Appol Group, Du Louvre/ Louvre Hotels Group.
Company form of investment	State-owned and private

27 "Trójmorze"; *Ministerstwo Spraw Zagranicznych*; (available at <https://www.gov.pl/web/dyplomacja/trojmorze>)

28 "EDPR announces the sale of minority stakes in Poland and Italy"; *EDP Energias de Portugal*; 28.12.2015 (available at <https://www.edpr.com/es/noticias/2015/12/28/edpr-announces-sale-minority-stakes-poland-and-italy>)

29 Sudak, Ireneusz; "Chińskie firmy realizują strategiczne inwestycje w naszej energetyce. Polskimi podwykonawcami"; *Wyborcza.pl*; 21.02.2017 (available at <http://wyborcza.pl/7,155287,21316107,jak-chinskie-firmy-buduja-bezpieczenstwo-energetyczne-polski.html>)

30 "Chiny liczą na Centralny Port Lotniczy. „Brama do Europy”"; *PolskieRadio.pl*; 21.02.2017 (available at <https://www.polskieradio.pl/42/259/Artykul/2120253,Chiny-licza-na-Centralny-Port-Lotniczy-Brama-do-Europy>)

31 "Centralny Port Komunikacyjny"; *Ministerstwo Infrastruktury*; (available at <https://www.gov.pl/web/infrastruktura/centralny-port-komunikacyjny>)



## MAIN TRENDS IN CHINESE INVESTMENTS IN POLAND IN 2013-2018. AN OVERVIEW.

According to estimates by Rhodium Group/ Mercator Institute for China Studies, from 2000 to 2017 Chinese FDI in Poland reached approximately 1.1 billion USD.<sup>32</sup> The numbers correspond roughly to those cited by Xu Jian, the Chinese Ambassador to Poland, who declared that total investments from China reached 1.3 billion USD as of early 2017.<sup>33</sup>

The structure of major investments in Poland is not much different from the general trend for Chinese business interests in Europe. It is related both to the booming ICT industry of the world's second largest economy, and to the need for Beijing to export its excess industrial output overseas. On the other hand, there is a noticeable increase in interest in green technologies, as well as in investments in research and development and in innovation. But Poland still lags behind Western Europe in this respect.

### CHINESE INVESTMENTS IN 2013-15:

In May 2013, a majority stake in Fabryka Łożysk Tocznych-Kraśnik S.A. (Rolling Bearings Factory - FŁT) was purchased by ZXY Luxembourg Investment S.a.r., which is based in Luxembourg but is part of Chinese-owned Tri Ring Group Corporation.<sup>34</sup> FŁT employs over 2 000 workers and staff.<sup>35</sup> In 2017, FŁT-Kraśnik S.A. had set up a Research and Development Centre within the factory.<sup>36</sup>

In 2013 - 15, three Chinese companies won tenders for building electric grid networks. These are Shanghai Electric Power Construction, Pinggao Group and Sinohydro Corporation.<sup>37</sup> Chinese authorities boast that the Pinggao Group's expansion and renovation of the Koźnice substation is the "first general contracting project for power transmission and transformation completed by a Chinese company in EU countries."<sup>38</sup> The

total value of the Pinggao Group's and Sinohydro Co.'s investments are estimated to reach 211 million USD.<sup>39</sup>

### CHINESE INVESTMENTS IN 2016:

Overall, 2016 was a record year: according to the Knight Frank report, Chinese FDI in Poland amounted to USD 563 million (the most among the Visegrad Group countries).<sup>40</sup>

Mostly, the bigger numbers in 2016 were the effect (among other things) of construction by the Suzhou Chunxing Precision Mechanical of a prototyping workshop in the Polish Baltic port city of Gdańsk (42 million USD).<sup>41</sup> It is one of world's leading manufacturers of aluminium components for the telecommunications, automotive and medical sectors. That project was meant to be a change from the previous domination of Mergers and Acquisitions (M&A). As the Polish Investment & Trade Agency claimed at the time, the "Chunxing investment is different. It will generate a constant creation of new jobs. New people will be hired within the development of the project".<sup>42</sup> Polish authorities linked the launch of that project with the recent visit of the Chinese President Xi Jinping to Warsaw, and said its aim was to "provide quick machining prototyping and warehouse/logistic service to European customers".<sup>43</sup>

Another remarkable investment was the acquisition by China Everbright International of Novago - the largest solid waste processing company in Poland. Its industrial profile includes municipal waste processing, recycling and the production of alternative fuels. The Chinese purchased Novago for roughly 140 million USD<sup>44</sup> It is worth highlighting that in 2018, the Provincial Inspectorate for Environmental Protection had noted some environmental issues relating to the landfills managed by the Novago company.<sup>45</sup>

32 Hanemann, Thilo; "EU - China FDI: working toward reciprocity in investment relations"; Rhodium Group and Mikko Huotari, *Mercator Institute for China Studies*; May, 2018.

33 Sudak, Ireneusz; "Chińskie firmy realizują strategiczne inwestycje w naszej energetyce. Polskimi podwykonawcami"; *Wyborcza.pl*; 21.02.2017 (available at <http://wyborcza.pl/7,155287,21316107,jak-chinskie-firmy-buduja-bezpieczenstwo-energetyczne-polski.html>)

34 "History"; *PBF Polish Bearings Factory*; (available at <http://flt.krasnik.pl/en/about-us/history>)

35 "Company presentation"; *PBF Polish Bearings Factory*; (available at <http://flt.krasnik.pl/en/about-us>)

36 "Research and Development Centre"; *PBF Polish Bearings Factory*; (available at <http://flt.krasnik.pl/en/about-us/research-and-development-center>)

37 Sudak, Ireneusz; "Chińskie firmy realizują strategiczne inwestycje w naszej energetyce. Polskimi podwykonawcami"; *Wyborcza.pl*; 21.02.2017 (available at <http://wyborcza.pl/7,155287,21316107,jak-chinskie-firmy-buduja-bezpieczenstwo-energetyczne-polski.html>)

38 "Chinese company completes power transmission projects in Poland"; *Belt and Road Portal*; 13.11.2018 (available at [https://eng.yidaiyilu.gov.cn/info/iList.jsp?tm\\_id=140&cat\\_id=10058&info\\_id=71506](https://eng.yidaiyilu.gov.cn/info/iList.jsp?tm_id=140&cat_id=10058&info_id=71506))

39 Sudak, Ireneusz; "Chińskie firmy realizują strategiczne inwestycje w naszej energetyce. Polskimi podwykonawcami"; *Wyborcza.pl*; 21.02.2017 (available at <http://wyborcza.pl/7,155287,21316107,jak-chinskie-firmy-buduja-bezpieczenstwo-energetyczne-polski.html>)

40 KnightFrank, *New Frontiers. Prospects for Real Estate Along the Belt and Road Initiative*. 1st Edition, The 2018 Report.

41 "Chunxing Group opens a prototyping workshop in Trójmiasto"; *Polish Investment & Trade Agency*; 04 July (available at [https://www.paih.gov.pl/20160704/chunxing\\_group\\_opens\\_a\\_prototyping\\_workshop\\_in\\_trojmiasto#](https://www.paih.gov.pl/20160704/chunxing_group_opens_a_prototyping_workshop_in_trojmiasto#))

42 "Chunxing Group opens a prototyping workshop in Trójmiasto"; *Polish Investment & Trade Agency*; 04 July (available at [https://www.paih.gov.pl/20160704/chunxing\\_group\\_opens\\_a\\_prototyping\\_workshop\\_in\\_trojmiasto#](https://www.paih.gov.pl/20160704/chunxing_group_opens_a_prototyping_workshop_in_trojmiasto#))

43 "Chunxing Group opens a prototyping workshop in Trójmiasto"; *Polish Investment & Trade Agency*; 04 July (available at [https://www.paih.gov.pl/20160704/chunxing\\_group\\_opens\\_a\\_prototyping\\_workshop\\_in\\_trojmiasto#](https://www.paih.gov.pl/20160704/chunxing_group_opens_a_prototyping_workshop_in_trojmiasto#))

44 Yang, Li; "Belt and Road constructions underway in Europe"; *Belt and Road Portal*; 16.10.2017 (available at [https://eng.yidaiyilu.gov.cn/home/rolling/30615\\_2.htm](https://eng.yidaiyilu.gov.cn/home/rolling/30615_2.htm))

45 "Zanieczyszczenie wód podziemnych na wysypisku w Uniszkach Zawadzkich"; *Codzienniklawski.pl*; 22.05.2018 (available at <https://codzienniklawski.pl/2018/05/22/zanieczyszczenie-wod-podziemnych-na-wysypisku-w-uniszkach-zawadzkich/>)

## SIGNIFICANT CHINESE INVESTMENTS IN 2017:

In August 2017, Smithfield Foods, a company belonging to the world's largest pork supplier, Chinese WH Group, purchased the meat plants Pini Polska, Hamburger Pini, and Royal Chicken.<sup>46</sup>

Furthermore, Jiangsu Olive Sensors High-Tech acquired a 32% stake in Schürholz Polska, which specializes in "punching and punch-bending, assembling, laser and CNC-bending"<sup>47</sup> technology as well as welding- and joining technologies.<sup>48</sup>

The year 2017 also saw LiuGong Dressta Machinery's opening of its European R&D Centre, European Parts Distribution Centre and New Manufacturing & Assembly Line for excavators and wheel loaders in its Stalowa Wola factory. Interestingly, that year the company was awarded the "Top Chinese Investor in Poland-2017" prize at the 5th annual FDI Poland Investor Awards.<sup>49</sup>

Investors from the Middle Kingdom have been also interested in the aviation industry: namely, Shaanxi Ligeance Mineral Resources acquired Gardner Aerospace Holdings Limited - a UK-based manufacturer of aerospace components which owns also facilities in Poland in Mielec and Tczew.<sup>50</sup>

One Chinese investment which needs particular attention is Hongbo Clean Energy Europe sp. z.o.o, which set up a new plant in Opole, in Poland's south-west, and created 100 new jobs. The factory produces LED lighting equipment. Hongbo Group has invested 100 million USD to build its LED lamp factory, which is "located in the Opole special economic zone and enjoys preferential tax treatments provided by the Polish local government". The Chinese government likes to highlight the fact that this is "the first Chinese greenfield investment project in Poland and it is being held up as a prime example of how the BRI is helping Chinese firms expand around the world."<sup>51</sup>

Similarly to Slovakia and Czechia, Chinese investors have interest in purchasing warehouse space in Poland. China Investment Corporation acquired a Logisor warehouse portfolio with many facilities.<sup>52</sup> As the

company states, the "majority of our properties are situated in Poland with 28 logistics parks across main locations including Warsaw, Central Poland, Silesia, Kraków and Poznań. 900,000 square meters in Poland makes us the third largest player within the industrial real estate sector."<sup>53</sup>

## MAJOR DEVELOPMENTS IN 2018:

Guotai-Huarong Poland (GTHR), a Chinese manufacturer of electric car battery components, decided to build a plant in Godzikowice, southwestern Poland. The investment is worth 45 million USD, and the factory is set to employ 60-100 workers. As the Polish government explained, the project is "part of Poland's Electromobility Development Plan, prepared and implemented by the Energy Ministry." Reportedly, the facility may be able to produce up to a million batteries a year.<sup>54</sup>

One of the most interesting Chinese investments in Poland is the world-famous high-tech company Nuctech, in Poland operating as Nuctech Warsaw Company Limited sp. z o. o. According to its own statement, "since 2005, more than 30 sets of cargo scanning systems were supplied by Nuctech Warsaw for customs authorities or government entities in EU territory. Now, in the factory facility in Warsaw, Nuctech Warsaw could produce all types of X-ray scanners including Mobile Scanners, Re-locatable Scanners, Gantry Scanners, Railway Scanners and Luggage Scanners, Liquid Scanners, Explosive Detectors, etc."<sup>55</sup>

Most recently, Nuctech Warsaw opened its new 6,000 square meter production facility with new offices and, critically, a research and development unit in Kobyłka near Warsaw. The Chinese company invested 10.5 million USD in the plant, and this is its only production facility in Europe and only the fourth world-wide, with the others being located in China, Brazil and UAE. In Poland, 23 Nuctech-manufactured scanners already work on road and rail border crossings and in seaports and airports, including the largest train scanner in Europe in Terespol on the Poland - Belarus border, enabling simultaneous scanning on three tracks.<sup>56</sup>

46 Kwok, Donny; "China's WH Group to buy Romanian meat producers in Europe push"; *Reuters*; 26.09.2017 (available at <https://uk.reuters.com/article/uk-wh-group-romania-acquisitions/chinas-wh-group-to-buy-romanian-meat-producers-in-europe-push-idUKKCN1C1022>; 26 September, 2017)

47 Computer numerically controlled (CNC) bending

48 "Schürholz - Tradition. Experience. Innovation."; Schürholz; (available at <https://www.schuerholz-group.com/index.php?id=18&L=1>)

49 "LiuGong Dressta Machinery receives the „Top Chinese Investor in Poland“ award"; *LiuGong*; 09.11.2017 (available at <https://www.liugong-europe.com/news/liugong-dressta-machinery-receives-top-chinese-investor-poland-award>)

50 "WFW advises Gardner Aerospace on its sale to SLMR"; *Watson Farley & Williams*; 23.06.2017 (available at <http://www.wfw.com/media-centre/news/wfw-advises-gardner-aerospace-on-its-sale-to-slmr/>)

51 Feng, Wang; "Chinese LED lighting maker enters into Polish market"; *China Plus*; 20.09.2018 (available at <http://chinaplus.cri.cn/news/business/12/20180820/172809.html>)

52 "Cushman and Wakefield with largest market share in Poland"; *Cushman&Wakefield*; 08.02.2018 (available at <http://www.cushmanwakefield.pl/en-gb/news/2018/02/cushman-and-wakefield-with-the-largest-market-share-in-poland>)

53 "Where we operate"; *Logisor*; (available at <https://www.logisor.eu/en-gb/where-we-operate/central-and-eastern-europe/>)

54 "Chinese company to invest USD 45 mln in Poland to build factory"; *PolandIn.com*; 30.05.2018 (available at <https://polandin.com/37446245/chinese-company-to-invest-usd-45-mln-in-poland-to-build-factory>)

55 "Nuctech Warsaw - About us"; *Nuctech Warsaw*; (available at <http://www.nuctechwarsaw.com/SitePages/SeNormalPage.aspx?nk=ABOUT&k=EADEDA>)

56 "Nuctech otwiera zakład produkcyjny pod Warszawą. Chiński gigant zainwestował miliony"; *Wiadomosci Warszawawa*; 26.09.2018 (available at <http://warszawa.naszemiasto.pl/artykul/nuctech-otwiera-zaklad-produkcyjny-pod-warszawa-chinski,4816621,art,t,id,tm.html>)



The company is planning to produce X-ray cargo scanning devices, among them mobile, railway and stationary models, and luggage scanners “based on the latest computed tomography scanning technology”.<sup>57</sup>

The Nuctech case is important as an exemplification of the complexity of Poland’s approach to security issues relating to sensitive foreign investments. Polish government officials claimed in interviews that they genuinely believe there is no security threat to Poland from Nuctech products. As they said, the opposite is true: reportedly, scanners and other devices produced by the company are of the “world’s highest quality” and are almost ‘indispensable’ for use on borders or at airports.

Another somewhat contentious case is that of Appol Group, a leading Polish fruit processing company acquired by Chinese SDIC Zhonglu Fruit Juice in June 2018. The acquisition was apparently the first M&A transaction made directly by a Chinese investor in the food processing sector.<sup>58</sup> However, there have been, some issues relating to the transaction, namely concerns on the part of Polish apple growers and some media outlets that thanks to the acquisition, the Chinese “company might try to flood the market with Chinese juice labelled as a Polish, and therefore EU, product.”<sup>59</sup> Polish apple growers expressed fears that the company might be mixing Chinese apple concentrate with the Polish one. Such situation has allegedly already occurred in the recent past.<sup>60</sup> It is worth noting that China is the world’s biggest apple producer.<sup>61</sup>

Mergers & Acquisitions as the type of investments favoured by China also include the real estate and hospitality industries. Europe’s second largest hotels group, Du Louvre (Louvre Hotels Group), was purchased by Shanghai’s International Hotels Development in 2014.<sup>62</sup> The Chinese company has over 7,500 hotels around the world. The Louvre Hotels Group owns more than 1,100 hotels in 51 countries, mainly under the brands Premier Classe, Campanile, Kyriad, and Golden Tulip.<sup>63</sup> It has 18

hotels in Poland, and they plan to double that number over the next two years. The company announced in September 2018 that it is going to open Europe’s first Chinese Metropol-brand four-star hotel in Kraków in 2019.<sup>64</sup>

In the ICT industry, Huawei Technologies is China’s global giant which has recently been placed under tight scrutiny related to security concerns by Europe and the USA.<sup>65</sup> In Poland, Huawei BCG Polska is a success story, as the company has had an impressive increase in its share of the market - from 8% in 2015 to 23% in 2017 and over 27% in 2018.<sup>66</sup> Increasingly, there is discussion in the West of excluding Huawei from building 5G network components. Meanwhile, in Poland this Chinese company had become an official partner of the “Agreement for 5G Strategy for Poland”. However, in late 2018, some Polish media had been speculating about an alleged warning the Polish government might have received from Washington to disengage from cooperation with Huawei.<sup>67</sup> Then, on 21 December last year, Polish Foreign Ministry issued a statement in which it said that “Poland shares the concerns about the cases of industrial espionage, including the actions assigned by our partners to China”.<sup>68</sup>

In fact, the question of using Huawei devices in public administration or to build a 5G network has been analysed by the Polish Government more intensively since the January 2019 incident involving arrests of a Chinese Huawei executive and a former Polish counterintelligence officer on charges of espionage.<sup>69</sup> The arrested Polish citizen was also an instructor at the prestigious War Studies Academy. The Chinese allegedly received information about “a secret project on the IT networks security being built by Polish scientists”.<sup>70</sup>

As a “tech cold war” looms, the situation became even more tense after the US envoy to the European Union openly warned Europeans about the risk of US countermeasures for allowing equipment from Huawei

57 “Nuctech Warsaw opens new office and production plant in Kobylka”; *ChinaDaily*; 29.09.2018 (available at <http://usa.chinadaily.com.cn/a/201809/29/WS5baf33d5a-310eff3032804bf1.html>)

58 “Sfinalizowano pierwszą transakcję M&A chińskiego inwestora w branży spożywczej w Polsce”; *Portalspozywczy.pl*; 15.06.2018 (available at <http://www.portalspozywczy.pl/owoce-warzywa/wiadomosci/sfinalizowano-pierwsza-transakcja-m-a-chińskiego-inwestora-w-branży-spozywczej-w-polsce,159696.html>)

59 “Record harvest a problem for Polish apple growers”; *Polandin.com*; 27.09.2018 (available at <https://polandin.com/39216573/record-harvest-a-problem-for-polish-apple-growers>)

60 “ŚIR: Chińczycy kupili firmę APPOL – Repolonizacja to hasło dla naiwnych”; *Sadownictwo.com.pl*; (available at <https://www.sadownictwo.com.pl/sir-chinczyki-kupili-firme-appol>)

61 “Belt and Road Initiative provides opportunity for Polish orchards”; *Ministry of Commerce People’s Republic of China*; 15.11.2016 (available at <http://english.mofcom.gov.cn/article/counselorsreport/asiareport/201611/20161101778967.shtml>)

62 Jing, Shi; “Shanghai Jin Jiang seals \$1.4b takeover of Louvre Hotels”; *ChinaDaily*; 16.01.2015 (available at [http://www.chinadaily.com.cn/business/2015-01/16/content\\_19334952.htm](http://www.chinadaily.com.cn/business/2015-01/16/content_19334952.htm))

63 “Warsaw Tourism Organization”; *Warsaw Tourism*; (available at <http://wot.waw.pl/czlonkowie/louvre-hotels-group/>)

64 Stefaniak, Piotr; “Nowe przedsięwzięcia Louvre Hotels w Polsce. Wchodzi duża chińska marka”; *wnp.pl*; 24.09.2018 (available at [https://budownictwo.wnp.pl/nowe-przedsiwziecia-louvre-hotels-w-polsce-wchodzi-duza-chinska-marka,330880\\_1\\_0\\_0.html](https://budownictwo.wnp.pl/nowe-przedsiwziecia-louvre-hotels-w-polsce-wchodzi-duza-chinska-marka,330880_1_0_0.html))

65 Fouche, Gwladys; “Norway considering whether to exclude Huawei from building 5G network”; *Reuters*; 09.01.2019 (available at <https://uk.reuters.com/article/uk-norway-huawei-tech-idUKKCN1P31NR>)

66 “Udział Huawei w rynku smartfonów w Polsce wzrósł do 33,4% w II kw.”; *Money.pl*; 02.08.2018 (available at <https://www.money.pl/gielda/wiadomosci/artykul/udzial-huawei-w-rynk-smartfonow-w-polsce,175,0,2412463.html>)

67 Czubkowska, Sylwia, “Huawei bierze na celownik Polskę. Plan: podbić naszą sieć 5G”; *Wyborcza.pl*; 18.12.2018 (available at <http://wyborcza.pl/7,156282,24287902,huawei-bierze-na-celownik-polske-plan-podbic-nasza-siec-5g.html>)

68 “Stanowisko MSZ s. cyberbezpieczeństwa przemysłowego”; *Ministerstwo Spraw Zagranicznych*; 21.12.2018 (available at [https://twitter.com/MSZ\\_RP/status/1076114768778444802](https://twitter.com/MSZ_RP/status/1076114768778444802))

69 Plucinska, Joanna, Witenberg, Karol, Stubbs, Jack; “Poland arrests Huawei employee, Polish man on spying allegations”; *Reuters*; 11.01.2019 (available at <https://www.reuters.com/article/us-poland-security-idUSKCN1P50RN>)

70 Zasada, Krzysztof; “Afera Huawei: Piotr D. miał przekazać informacje ws. polskiego, tajnego projektu bezpieczeństwa”; *RMF24*; 19.02.2019 (available at <https://www.rmf24.pl/fakty/news-afere-huawei-piotr-d-mial-przekazac-informacje-ws-polskiego-nld,2844120>)

Technologies to be used in critical infrastructure projects.<sup>71</sup> The same message was brought to the Visegrad countries on the tour made by US secretary of state, Mike Pompeo who visited Budapest, Bratislava and Warsaw on February 11-14, 2019. In this way, US Department of State warned Central Europe that technological cooperation with China “makes it more difficult for America to be present. That is, if that equipment is co-located where we have important American systems, it makes it more

difficult for us to partner alongside them.”<sup>72</sup> It was possible to read those statements as an US “offer” to take sides in the Beijing-Washington conflict and – in fact – choose between them. Of course – apart from an obvious fierce technological competition between the United States and China – there is rationale for American concerns and it is linked to a tight cyber security cooperation of NATO allies. The related problem is also Beijing-Moscow strategic military partnership and ensuing threats.

## 4. SCREENING MECHANISM

### LEGISLATION

On November 20, 2018, the European Union reached a provisional agreement on a framework for screening foreign direct investments (FDI) in strategic sectors of the European economy and an EU-wide “cooperation mechanism”.<sup>73</sup> Warsaw hopes for a more efficient information flow and greater transparency, which could facilitate “assessment of investments, for example, in terms of the involvement of third-country governments (e.g. Russia).”<sup>74</sup>

Poland, confronted with Russian attempts to acquire some of its strategic assets (e.g. Grupa Azoty S.A., a Polish strategic chemical producer, by the Russian company Acron<sup>75</sup>), decided in 2015 to regulate that area to protect its industries and businesses against foreign hostile takeovers that could threaten the state and public security. This legislation, however, is not meant to screen the whole spectrum of foreign business activity in the country. The legislators chose to act in a very limited way.

The Polish Act of 24 July 2015 “On the Control of Certain Investments” is aimed at screening investments in sectors of strategic importance for the economy, particularly energy and the defence industry. Lawmakers authorized the Polish government to specify by way of regulation a list of entities subject to protection, which is to be open to the public. Such a list may – but doesn’t need to – be issued every year. Polish Parliament, granting authorization to issue a regulation with a list of protected

companies, had obliged the government to take the following into account: the significance of the share of a given foreign business organization in the market, the scale of the conducted activity, presence of a real and sufficiently serious threat to fundamental interests of the state, as well as the lack of other options for introducing less restrictive measures.<sup>76</sup> What is of critical significance, the protection can be activated prior to the actual acquisition and it allows state authorities to control transactions that could threaten public security and public order preemptively.

The mechanism in question had been designed to work in a very specific way: a business organization that is going to acquire a “material stake” of 20% or higher in a company specified in the government’s regulation is obliged to notify the government itself. The Minister of Energy or the Prime Minister may raise objections and veto the purchase.<sup>77</sup> Failure, however, to notify the relevant government bodies may result in the transaction being declared null and void and a fine up to approximately 26 million USD be imposed on the purchaser. An additional penalty of six months to five years of imprisonment may be imposed by courts – dependent on specific cases.

It is worth noting that according to the U.S. Department of State, the mechanism in question “does not appear to constitute a de facto barrier for [foreign] investment”.<sup>78</sup> The operation of the Act of 24 July 2015 is also limited by the Bilateral Investment Treaties (BITs) Poland is party to, including the Poland – China agreement concluded in 1988. On the other

71 “Any Western country using Huawei or other Chinese tech makers in major projects will risk consequences, US ambassador warns”; *South China Morning Post*; 08.02.2019 (available at <https://www.scmp.com/news/world/europe/article/2185354/germany-wants-avoid-banning-huawei-5g-networks-report-says>)

72 Lee, Matthew; “US warns Hungary, other allies to shun business with Huawei”; *AP News*; 11.02.2019 (available at <https://www.apnews.com/aa77ed1114ed45eb810ab67f4e84c1bb>)

73 “Screening of investments: political agreement reached on an EU framework”; *Council of the European Union*; 20.11.2018 (available at <https://www.consilium.europa.eu/en/press/press-releases/2018/11/20/screening-of-investments-political-agreement-reached-on-an-eu-framework/>)

74 Szczudlik, Justyna, Wnukowski, Damian; “Reforma mechanizmów kontroli inwestycji w USA i UE: odpowiedź na aktywność Chin”; *PISM*; 02.01.2019 (available at <http://www.pism.pl/publikacje/biuletyn/nr-1-1749>)

75 “Tarcza przeciw wrogim inwestycjom – nowa ustawa o kontroli niektórych inwestycji”; *K&L Gates*; September 2015 (available at <http://www.klgates.com/pl/tarcza-przeciw-wrogim-inwestycjom--nowa-ustawa-o-kontroli-niektorych-inwestycji-09-09-2015/>)

76 Rozporządzenie Rady Ministrów z dnia 8 grudnia 2016 r. w sprawie wykazu podmiotów podlegających ochronie; RM-110-157-16

77 Previously it was Ministry of State Treasury which was dissolved in January, 2017 and oversaw strategic companies where the Government has had stakes. In energy sector its prerogatives were passed to the Ministry of Energy, others are under supervision of Prime Minister. One of those strategic firms is the abovementioned Grupa Azoty S.A. : Spółki z udziałem Skarbu Państwa; <https://nadzor.kprm.gov.pl/spolki-z-udzialem-skarbu-panstwa>; 10 January, 2019 (retrieved 8 February, 2019).

78 “Poland: investment climate statements”; U.S. Department of State; 19.07.2018 (available at <https://www.state.gov/e/eb/rls/othr/ics/2018/eur/281623.htm>)

hand, the real issue is proportionality of that measure, and whether the Polish regulation might be in breach of the European Union's primary legislation, in particular the Treaty on the Functioning of the European Union (TFEU) clause concerning "means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments" (TFEU, Article 65). Opinions vary in this regard.

## POLISH EXPERIENCE WITH BLOCKING CHINESE INVESTMENTS

While the Act of 24 July, 2015 is well-suited to protect large companies of strategic importance for the country and its economy, the most controversial case of the blocking of a potential Chinese investment in Poland involved a simpler solution. The central Polish city of Łódź had envisioned itself as a Belt and Road logistics hub for Central Europe, benefiting from a cargo railway connection with the Chinese city of Chengdu. In its proponents' eyes, constructing a container terminal could bring more opportunities for exporting Polish food to China, and as such more development prospects to the city. The project was reportedly

discussed during the visit of Chinese President Xi Jinping to Poland in June, 2016. The piece of land satisfying the project's needs happened to be owned by the Polish Military Property Agency. They were seeking an investor anyway, and finally they agreed with a Chinese one. The project was worth roughly 21 million USD. Eventually, however, the tender was withdrawn by the Agency, with media speculations on a direct involvement of the defence minister, who allegedly had decided himself to block the sale, citing security concerns. Some observers believed there were also American suggestions to make such a decision.<sup>79</sup>

In 2018, a consortium including the Chinese company Stecol Corp. won a tender for the construction of the northern section of the Krakow ring road. However, the National Board of Appeal (KIO) cancelled the results and excluded Stecol from the tender. Even prior to this, Stecol Corp. won the tender for the construction of a section of the new two-lane national road 47. Again, the National Board of Appeal rejected Stecol's offer. The KIO cited non-compliance of the offer's contents with the Specification of Essential Terms of the Contract as grounds for its decision.<sup>80</sup>

## 5. CONCLUSION

Sino-Polish relations have made a long journey since the launch of the "16+1" format: 'China – Central and Eastern Europe Cooperation', in early 2012. The early enthusiasm of some political and business elites has meanwhile evaporated. Implementation of agreements signed in 2016 on the visit of China's President Xi Jinping to Warsaw also failed to fulfil Poland's expectations. What ensued is a relative disillusionment, which is an effect of lower-than-expected Chinese investments in Poland, the persisting tremendous barriers to trade in China, and weak involvement on the part of Beijing despite Warsaw's 'goodwill' and its geopolitical location.

On the Polish side, however, there is no uniform vision of how to design Poland's relations with China in order to boost the country's standing vis-à-vis Beijing. Instead, there are contradictory signals sent to the world's second largest economy. Warsaw has not developed a comprehensive, long term strategy (e.g. one comparable with the Slovak strategy adopted in April, 2017).<sup>81</sup> The government started working on it several years ago, but then the work discontinued as it required approval across ministries, which was hard to receive due to too many differences among them.

It seems that for Beijing, Warsaw is only a small element of a larger economic and geostrategic puzzle in Eurasia, and the attractiveness of Poland for China depends on the current geopolitical situation of China itself and its relations with the West. There is also suspicion that Sino-Polish ties have become hostage to Sino-American relations and the ongoing trade war. Symptomatic for a new approach to the mutual relations are views expressed by the Polish Prime Minister Mateusz Morawiecki in 2018: "In practical terms, the possibility of providing services by foreign entities in China is extremely difficult. It is sometimes worthwhile to throw off the yoke of political correctness, look at the numbers and say what the real challenges of the modern world are. And the United States also thinks so. We need free and fair trade, as President Trump rightly pointed out".<sup>82</sup>

As for potential threats from Chinese investments, Poland has well-working legal and administrative mechanisms for screening and blocking possibly undesirable purchases or takeovers in sensitive industries. The Law of 24 July, 2015, is one of them. Now thanks to the joint European cooperation mechanism to be implemented in the EU's (post-Brexit) 27 member countries, protection tools are expected to be further strengthened.

79 Pietrzak, Leszek; "Bitwa o Polskę"; *Gazeta Finansowa*, 30.01.2017 (available at <https://gf24.pl/wydarzenia/polityka/item/472-bitwa-o-polske>)

80 "Chińczycy wykluczeni z kolejnego przetargu. Mieli zbudować ważne odcinki dróg"; *Tvn24Bis*; 07.09.2018 (available at <https://tvn24bis.pl/z-kraju,74/chinczyki-wykluczeni-z-przetargu-na-polnocna-obwodnice-krakowa,866876.html>)

81 "Vláda schválila Koncepciu rozvoja hospodárskych vzťahov medzi SR a Čínou na roky 2017 až 2020"; *Ministerstvo hospodárstva Slovenskej republiky*, 11.04.2017 (available at <https://www.mhsr.sk/press/vlada-schvalila-koncepciu-rozvoja-hospodarskych-vztahov-medzi-sr-a-cinou-na-roky-2017-az-2020>)

82 Goduslawski, Bartek; "Morawiecki: Polexit jest tak samo możliwy jak Germanexit. Polska jest i pozostanie częścią UE"; *Forsal*; 28.01.2018 (available at <https://forsal.pl/gospodarka/polityka/artykuly/1100697,morawiecki-polexit-jest-tak-samo-mozliwy-jak-germanexit.html>)

## SERBIA

# "STEEL FRIENDSHIP" OF CHINA AND SERBIA

## 1. GEOPOLITICAL AND ECONOMIC OVERVIEW

In recent years Serbia has become China's biggest trade partner in the Western Balkans. National Security Strategy of Serbia from 2009 has defined China as one of the "four pillars" upon which its foreign policy rests; the others being the EU, Russia and USA, claiming it to be one of the most important partners in international relations. China is also present in Serbia through infrastructure and several other notable investment projects financed by Chinese banks.

Serbia and China are historically connected by the legacy of communism, that is, socialism as a form of socio-political order. As is often pointed out, China was, along with Russia, one of the two permanent members of the United Nations Security Council that did not recognize the unilaterally declared independence of Kosovo. From its side, Serbia has openly expressed its support for the Chinese position with regard to the territorial disputes in the South China Sea, as well as on the territory of Tibet and Xinjiang.

Five years ago, Belgrade hosted the 16+1 summit, now the traditional forum for cooperation between China and the countries of Eastern and Central Europe, which brings together the highest officials of these countries annually. In addition to meetings in the multilateral format, Chinese president Xi Jinping has visited Serbia several times. The first visit by the Chinese leader was during the 16 + 1 meeting organized in Belgrade in 2014, while the second was a bilateral meeting in 2016, when Xi Jinping met with then-Serbian President Tomislav Nikolić. On the other hand, Serbian representatives have visited Beijing on several occasions. In 2017, Nikolić visited Beijing and during that visit he received the title of "Honorary Citizen of Beijing".<sup>83</sup> It is interesting to point out that Nikolić's visit to Beijing was one of his last visits before stepping down from the Serbian presidency. Since then, he has become the head of the newly established Office for Cooperation with Russia and China.

The new, and current president of Serbia, Aleksandar Vučić, visited Beijing in September of 2018 and highlighted the importance of Serbia's "steel friendship" with China on several occasions.<sup>84</sup> Cooperation with China has become an important political tool for Serbian politicians. Public opinion polling conducted by Belgrade Centre for Security Policy in 2017<sup>85</sup> showed that 52% of the people included in the survey consider Chinese influence on Serbian foreign policy to be good or mostly good, and that puts China on second place behind Russia (61%) and ahead of Germany (35%), followed by the EU and the USA. The importance of China's presence to the current Serbian government is illustrated by one recent example. As the ruling Progressive Party celebrated 10 years of its existence in October 2018, the only foreign ambassador to be invited on stage was the Chinese Ambassador Li Manchang.<sup>86</sup> Most recently, Serbian President Aleksandar Vučić has acknowledged that he consulted with the Chinese Ambassador and leadership figures regarding the current situation in the Belgrade-Prishtina dialogue, and asked for support with regard to the formation of the Kosovo Army.<sup>87</sup>

Concerning cultural cooperation, two Confucius Centers have been opened in Serbia, one in Belgrade and one in Novi Sad. In addition, a new Chinese cultural center is currently under construction on the spot of the former Chinese Embassy in Yugoslavia that was destroyed during the NATO intervention in Serbia in 1999.<sup>88</sup> Concurrently, in November of 2018 a Serbian Cultural Center was opened in Beijing. This is only the second cultural center that Serbia has opened anywhere in the world, the first having opened in Paris. In 2012, and Mandarin language courses have become part of the curriculum in some elementary and high schools in Serbia.<sup>89</sup>

83 "China, Serbia, vow to solidify friendship, cooperation"; *CCTV*; 31.03.2017 (available at <http://english.cctv.com/2017/03/31/ART1xuxQ5PEyQ5vE021uRYYe170331.shtml>)

84 "Vucic: Serbia-China Friendship made of steel"; *B92*; 12.03. 2018 (available at [https://www.b92.net/eng/news/politics.php?yyyy=2018&mm=03&dd=12&nnav\\_id=103685](https://www.b92.net/eng/news/politics.php?yyyy=2018&mm=03&dd=12&nnav_id=103685))

85 "Public Perception of Serbia's Foreign Policy"; *Belgrade Centre for Security Policy*; 08.03.2017 (available at [http://bezbednost.org/upload/document/public\\_perception\\_of\\_serbias\\_foreign\\_policy.pdf](http://bezbednost.org/upload/document/public_perception_of_serbias_foreign_policy.pdf))

86 "Decade of Progressive Party creates basis for Serbia's development: Serbian President"; *Xinhua*, 22.10.2018 (available at: [http://www.xinhuanet.com/english/2018-10/22/c\\_137549115.htm](http://www.xinhuanet.com/english/2018-10/22/c_137549115.htm))

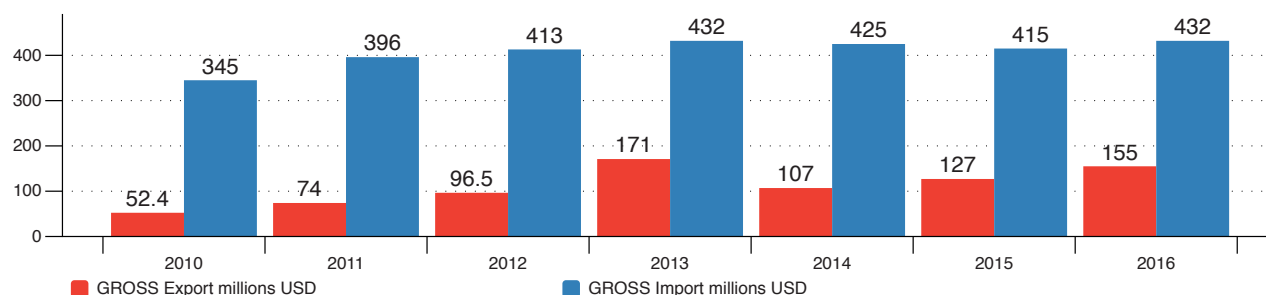
87 "Belgrade Seeks China support after Pristina says it will build Army"; *Beta*; 04.12.2018 (available at: <http://rs.n1info.com/English/NEWS/a441133/Belgrade-asks-China-s-support-after-Pristina-says-it-will-create-own-army.html>)

88 "China's Martyr's Day: Chinese cultural Center in Belgrade Under Construction"; *CCTV*; 30.09. 2017 (available at [https://news.cgtn.com/news/3d636a4e31494464776c6d636a-4e6e62684a4856/share\\_p.html](https://news.cgtn.com/news/3d636a4e31494464776c6d636a-4e6e62684a4856/share_p.html))

89 "Kineski jezik u srpskim školama"; *RTS*; 14.03.2012 (available at <http://www.rts.rs/page/stories/sr/story/125/drustvo/1062940/kineski-jezik-u-srpskim-skolama.html>)



Figure 6. Serbia – China trade



Source: ATLAS OF ECONOMIC COMPLEXITY (AEC)

## 2. TRADE RELATIONS BETWEEN SERBIA AND CHINA

The trade relations between Serbia and China show that there have been improvements in cooperation between the two countries. Nonetheless, the largest trade partners of Serbia remain neighboring countries that are part of Central European Free Trade Agreement (CEFTA) and the EU. Serbia is still primarily oriented towards these markets, especially with regards to its exports. Trade statistics differ between the available sources and aggregation methodologies, but some general conclusions can nonetheless be made.

The total amount of foreign trade between Serbia and China has generally been on the rise from 2010 onwards. Based on data provided by Statistical Office of the Republic of Serbia (SORS),<sup>90</sup> in 2010, China was ranked the 48th largest market for exports from Serbia, falling out of the top 50 countries between 2010 and 2017 several times. In 2017 it ranked 30th on that list. Serbia is significantly more reliant on China as an import market; from 2010 to 2017, China was placed either third or fourth on the list of Serbia's largest sources of imports. While imports from China were 1,17 billion USD in 2010, they have grown to 1,76 billion USD in 2017.

It is clear that in recent years the total foreign trade exchange amount has been constant, but there has been growth in exports since 2010 onwards, especially after the launch of 16+1 platform, when exports jumped from 96,5 million USD in 2012 to 171 million in 2013, according to The Atlas of Economic Complexity (AEC).<sup>91</sup> Even with that increase, China is still low on

the list of countries that Serbia exports to, with only 0,4% of total exports bound for China in 2017.

Of those exports, from 2010 until 2013 the main export sector was metal which comprised more than 50% of total exports in that period, and even reached 88,19% in 2013, and the most of the export was oriented towards heavy industry.<sup>92</sup> Since 2013, the main export sector has become tobacco and tobacco products, which have amounted to almost 43% of total exports. The reason for this is mostly a drop in metal exports, from 151 million USD in 2013 to just over 30 million USD in 2014.<sup>93</sup> A key reason for this sharp drop-off is that the biggest steel plant in Serbia, Smederevo steel plant, almost shut down as a result of its previous owner, U.S. Steel, leaving the market. Still, overall exports continued to grow, reaching an all-time high in 2017.

The situation is substantially different with imports from China. China is one of Serbia's top-four major sources of imports. The main import sectors are machinery and transport equipment, followed by miscellaneous manufactured articles and telephone equipment.<sup>94</sup> The latter may be indicative of the strong presence of Chinese telecommunications firm Huawei in Serbia. In recent years, imports from China have risen consistently. Data from AEC shows that in 2010 Serbia's imports from China totalled 345 million USD, while in 2016 that amount was 432 million USD. The data provided by SORS is even more indicative. It shows that in 2017 Serbia imports from China totalled 1,76 billion USD, constituting

<sup>90</sup> "Country of destination rank/origin, by value of export/imports"; *Statistical Office of the Republic of Serbia*; (available at [http://data.stat.gov.rs/Home/Result/170401?languageCode=en-US&displayMode=table&guid=2ebe67f7-0fc4-4458-ab31-49e95758e431&fbclid=IwAR0I2d4PVbR9K45D1-3vCrTCjg-d\\_O8bU4daFAGwjeeg2BNZC5hHPP6Dzw](http://data.stat.gov.rs/Home/Result/170401?languageCode=en-US&displayMode=table&guid=2ebe67f7-0fc4-4458-ab31-49e95758e431&fbclid=IwAR0I2d4PVbR9K45D1-3vCrTCjg-d_O8bU4daFAGwjeeg2BNZC5hHPP6Dzw))

<sup>91</sup> "What did Serbia export to China in 2013"; *Atlas of Economic Complexity*; (available at <http://atlas.cid.harvard.edu/explore/?country=201&partner=43&product=undefined&productClass=SITC&startYear=undefined&target=Partner&year=2013&fbclid=IwAR0hJFBbJ3ZfvqaUSbFKfKbn-QdgCzv6YuDd83LzWLgrhCb56hJqS5i2sA8>)

<sup>92</sup> "What did Serbia export to China in 2013"; *Atlas of Economic Complexity*; (available at: <http://atlas.cid.harvard.edu/explore/?country=201&partner=43&product=undefined&productClass=SITC&startYear=undefined&target=Partner&year=2013&fbclid=IwAR0hJFBbJ3ZfvqaUSbFKfKbn-QdgCzv6YuDd83LzWLgrhCb56hJqS5i2sA8>)

<sup>93</sup> According to Atlas of Economic Complexity

<sup>94</sup> "Spolnotrgovinska razmena Republike Srbije i Narodne Republike Kine"; *Serbian Chamber of Commerce and Industry*; 01.01.2018 (available at: [http://pks.rs/Documents/Centar\\_za\\_bilateralnu\\_saradnju\\_i\\_koordinaciju\\_rada\\_predstavni%C5%A1tava/KINA.pdf](http://pks.rs/Documents/Centar_za_bilateralnu_saradnju_i_koordinaciju_rada_predstavni%C5%A1tava/KINA.pdf))

8,1% of Serbia's total imports that year and making China Serbia's third-largest source of imports.

The data provided demonstrates that China is an important factor in Serbia's foreign trade mix, but is still far from being the single most

significant presence. Serbia is predominantly oriented towards the European market, and leans heavily on existing agreements like CEFTA. But given the rising presence of Chinese companies on Serbian territory, the constant increase in trade since 2010, and the rapid evolution of Sino-Serbian relations, the situation could change in years to come.

### 3. CHINESE INVESTMENTS IN SERBIA – AN OVERVIEW

Chinese investments in Serbia started rising in 2009 with the signing of an Agreement on Economic and Technical Cooperation between the government of the Republic of Serbia and the government of the People's Republic of China. This agreement involved financial and technological cooperation on infrastructure projects in Serbia. On the Serbian side, the agreement was signed by then-Minister of Economy Mladjan Dinkic, and was endorsed by former president Boris Tadic.<sup>95</sup> The agreement served as a foundation for the first major infrastructural project conducted in Serbia by Chinese investors, specifically the construction of the Zemun – Borca bridge over the Danube river; it is part of the important "North Tangent", the road corridor linking Serbia to Central Europe. This project was followed by several other important agreements on infrastructural projects in years to come, but will be remembered as the first of its kind.

In this regard, it is of great importance to draw a distinction between investments and loans when discussing incoming Chinese capital flows in Serbia, all the more so given that politicians are prone to equating the two. In June 2017, Zorana Mihajlović, Serbian Minister of Infrastructure, said that at that point, Chinese investments in Serbia under the China-led Belt and Road Initiative megaproject had exceeded 6 billion USD.<sup>96</sup> When asked about the increased Chinese presence in Serbia, Mihajlović claimed: "It's not easy to get credit from Western states...When we speak about this with European countries, they say 'why China?' Because they have the money, to be honest."<sup>97</sup> Chinese loans are an alternative to funding coming from European and international institutions, and they usually come with interest rates of 2-2.5% and long repayment periods. Data from the National Bank of Serbia show that total Chinese investment in Serbia from 2009 to 2017 was around 300 million USD.<sup>98</sup> The discrepancy in the amount of investment flows points to loans from Chinese banks that were used for financing projects rather than direct investments.

A number of significant investment projects were announced in 2018. Both countries signed several notable agreements that are expected to bring around 3 billion USD of investments into Serbia.<sup>99</sup> The majority of those agreements were signed during the visit of a Serbian delegation to Beijing in September of 2018, headed by President Vučić and several national ministers. Serbian representatives signed contracts with representatives of Chinese companies and Chinese state representatives during that visit. Those agreements included greenfield projects like the construction of a tire factory in Zrenjanin, a Chinese takeover of the firm Mining and Smelting Combine Bor (RTB Bor), and construction of an industrial park close to Belgrade.

The biggest joint projects, whether they stem from investments or loans from the Chinese side, are mostly in the area of infrastructural projects and those connected to the energy sector. This is consistent with the overall plan of the Chinese Belt and Road Initiative, and with Serbia's geographical position. Investments in these areas secure other Chinese investments throughout the region, not only in Serbia. The investment in infrastructure connects strategically important points, like the Greek port of Piraeus with Central and Western Europe. Investments in the energy sector, on the other hand, ensure that China will have sources of construction materials in Serbia, and will be able to distribute resources to other countries using routes that Chinese companies constructed.

#### MAJOR INFRASTRUCTURE PROJECTS

The first major Chinese project in Serbia was based on an agreement signed in 2009. The Bridge of Chinese – Serbian friendship over Danube River that connected two shores of the Danube was officially opened in 2014 during the visit of Chinese Prime Minister Li Keqiang.<sup>100</sup> The total cost of the project was 203 million USD, with 85% of its financing coming

95 "Serbia, China sign framework agreement on economic, technological infrastructure cooperation"; *The Government of the Republic of Serbia*; 21.08.2009 (available at <https://www.srbija.gov.rs/vest/en/58295/serbia-china-sign-framework-agreement-on-economic-technological-infrastructure-cooperation.php>)

96 Ralev, Radomir; "China's infrastructure investments in Serbia reach 5.5 bln euro – Serbian govt"; *SEE News*; 15.06.2017 (available at: <https://seenews.com/news/chinas-infrastructure-investments-in-serbia-reach-55-blm-euro-serbian-govt-572427>)

97 Karnitschinig, Matthew; "Beijing's Balkan Backdoor"; *Politico*; 18.07.2017 (available at: <https://www.politico.eu/article/china-serbia-montenegro-europe-investment-trade-beijing-balkan-backdoor/>)

98 "Cumulative FDI inflows in Serbia – absolute and relative terms"; *National Bank of Serbia*; 2018 (available at [https://www.researchgate.net/figure/Cumulative-FDI-inflows-in-Serbia-absolute-and-relative-terms-Source-National-Bank-of-fig8\\_326504186](https://www.researchgate.net/figure/Cumulative-FDI-inflows-in-Serbia-absolute-and-relative-terms-Source-National-Bank-of-fig8_326504186))

99 Zivanovic, Maja; "\$3bn Economic Agreements Boost China's Role in Serbia"; *BIRN*; 18.09.2018 (available at: <http://www.balkaninsight.com/en/article/new-agreements-boost-china-role-in-serbia-09-18-2018>)

100 "Belgrade's new Danube bridge officially opened"; *B92*; 18.12.2014 (available at [https://www.b92.net/eng/news/politics.php?yyyy=2014&mm=12&dd=18&nav\\_id=92612](https://www.b92.net/eng/news/politics.php?yyyy=2014&mm=12&dd=18&nav_id=92612))

from China's Export-Import Bank (Exim Bank). The other 15% came from the City of Belgrade. China's Road and Bridge Corporation (CRBC) was responsible for its construction.<sup>101</sup>

One of the more controversial projects funded by Chinese loans is the construction of a high-speed railroad that would connect Belgrade with the Hungarian capital, Budapest. Serbia borrowed 297,6 million USD from Exim Bank in order to fund this project, and the construction of the railroad on the Serbian side will be conducted in cooperation with Chinese investors and Russia's RZD International. Besides financial cooperation, the reconstruction of the railway will be carried out by the consortium of Chinese companies including China Railway International and China Communications Construction Company (CCCC), and Russian RZD, that will be working on the different parts of the railroad through Serbia. Part of the project will be financed through a Russian loan.<sup>102</sup> The project was agreed to during the 16+1 summit in 2013, where the initial memorandum of understanding was signed by Serbia, Hungary and China. This railroad should connect Central Europe with the Chinese-owned Piraeus port in Greece. Since 2013, there has been some construction on the Serbian side of the border, while nothing has yet been done in Hungary. The initial date planned for the start of construction was 2015, but this goal went unmet. The European Commission raised questions, mainly targeted at Hungary, about the public tender process that preceded the beginning of construction.<sup>103</sup> During the 16 + 1 summit in Sofia, Bulgaria in July 2018, Serbia, Hungary and China signed a new contract regarding the railroad project. In order to follow the procurement procedures of the EU, the project now includes a public tender that will be conducted by Hungary.<sup>104</sup> Since then, a new contract has been signed between the Serbian government and a Chinese consortium for construction of the section of the railroad running between Novi Sad and Subotica.<sup>105</sup> Construction on the Hungarian side is projected to start during the first half of 2019, and to be finished by 2023.

In 2018 China's Road and Bridge Corporation (CRBC) also signed a memorandum of understanding with the Serbian Government for the Belgrade – Niš railroad reconstruction.<sup>106</sup> This railroad is the southern path to the above-mentioned port of Piraeus, and the approximate value of the

project is 685 million USD. It will connect Piraeus with Central Europe through Niš, Belgrade and Budapest.

Another project, Highway Corridor 11, is currently under construction in Serbia. This highway should connect Belgrade with the port of Bar in Montenegro. China's Exim Bank provided loans for construction projects on three different parts of Corridor 11. A highway bypass around Belgrade that will connect the cities Obrenovac and Surcin is one of those projects. In 2013 the Serbian government signed a construction contract with Shandong International Economic and Technical Cooperation Group, valued at 224 million USD. Another infrastructural project involved the construction of two additional parts of Highway Corridor 11. The total value of the investment project was 334 million USD. The vast majority of the investment was financed through a 301 million USD Exim Bank loan. Shandong Hi Speed Group was contracted to construct two additional sections of Corridor 11, Obrenovac – Ub, and Lajkovac – Ljig.<sup>107</sup> The Chinese loan came with a 2,5% per annum interest rate.<sup>108</sup> In addition, Serbian Minister of Infrastructure in 2018 announced that a memorandum of understanding had been signed in March with China Communications Construction Company (CCCC), of which CRBC is a subsidiary, for the construction of the 107 km-long Požega-Boljare motorway section. CRBC will be in charge of preparing the project documentation - an assignment with a cost projected at 57 million USD.<sup>109</sup>

## MAJOR PROJECTS IN ENERGY SECTOR

All of the aforementioned loans are primarily dedicated to projects linked with transport infrastructure in Serbia. Serbia has also taken other loans from Chinese financial actors for projects that are tied to other strategically important areas of the Serbian economy.

After initial contract signed in 2011 between Government of Serbia and Exim Bank,<sup>110</sup> regarding 293 million USD loan, In 2014, Serbian government took an additional 608,2 million USD loan from Exim Bank, based on a general contract agreement for the realization of a package of projects involving the second phase of construction on Kostolac-B Power Plant. Once concluded, it gave a preferential position to Chinese

101 "China Road and Bridge Corporation"; *CSEACN*; (available at: <http://cseacn.org/crbc-eng/?lang=en>)

102 "Annex signed to Russia's USD 800mIn Serbian Railways loan"; *B92*; 15.07.2016 (available at: [https://www.b92.net/eng/news/business.php?yyyy=2016&mm=07&dd=15&nav\\_id=98626](https://www.b92.net/eng/news/business.php?yyyy=2016&mm=07&dd=15&nav_id=98626))

103 Shepard, Wade; "Another Silk Road Fiasco? China's Belgrade to Budapest High-Speed Rail Line Is Probed by Brussels"; *Forbes*; 25.02.2017 (available at <https://www.forbes.com/sites/wadeshepard/2017/02/25/another-silk-road-fiasco-chinas-belgrade-to-budapest-high-speed-rail-line-is-probed-by-brussels/#70ea58e83c00>)

104 Béni, Alexandra; "Government to call new tender for Budapest-Belgrade Railway Upgrade"; *Daily News Hungary*; 29.12.2018 (available at <https://dailynewshungary.com/government-to-call-new-tender-for-budapest-belgrade-railway-upgrade/>)

105 "Serbia and China sign EUR 943 million contract"; *Railway Pro*; 10.07.2018 (available at <https://www.railwaypro.com/wp/serbia-and-china-sign-eur-943-million-contract>)

106 "Memorandum on reconstruction of Serbian Railway Signed"; *Beta*; 06.07.2018 (available at <http://rs.n1info.com/English/NEWS/a402036/Memorandum-on-reconstruction-of-Serbian-railway-signed.html>)

107 *The Book of Projects*, Ministry of Construction, transport and Infrastructure, 2017, available at: <https://www.mgsi.gov.rs/sites/default/files/The%20book%20of%20projects%20MCSI%202017.pdf>

108 *Preferential buyer credit loan Agreement on construction of highway E-763 (section Obrenovac-Ljig) Project between the Government of the Republic of Serbia represented by the Ministry of finance and economy as borrower and the Export-import bank of China as lender*, 26.08.2013, available at: [www.pravno-informacioni-sistem.rs/SIGlasnikPortal/eli/rep/mu/skupstina/zakon/2013/13/9/reg?fbclid=IwAR1gxo\\_meX2FgLmYLhPvxX7mc-Lsj2qXKLLwnhOoEkA1NBbduK3r8hdrRh](http://www.pravno-informacioni-sistem.rs/SIGlasnikPortal/eli/rep/mu/skupstina/zakon/2013/13/9/reg?fbclid=IwAR1gxo_meX2FgLmYLhPvxX7mc-Lsj2qXKLLwnhOoEkA1NBbduK3r8hdrRh)

109 Ralev, Radomir; "Serbia plans no borrowing to finance Preljina-Pozega Motorway Construction"; *SeeNews*; 05.06.2018 (available at <https://seenews.com/news/serbia-plans-no-borrowing-to-finance-preljina-pozega-motorway-construction-615195#sthash.SCfd00fz.dpuf>)

110 *Preferential Buyer Credit Loan Agreement on Phase I of the Package Project Kostolac-B Power Plant Projects between The Government of the Republic of as a borrower and The Export-Import Bank of China as Lender*, 26.12.2011. Available at: <http://www.pravno-informacioni-sistem.rs/SIGlasnikPortal/eli/rep/mu/skupstina/zakon/2012/1/4/reg>



Machinery Engineering Corporation (CMEC) for implementation of the package, which involved upgrading the existing Kostolac power plant and building an additional production unit.<sup>111</sup> The Kostolac-B power plant is one of the biggest energy suppliers in Serbia. This contract is the second phase of the project, the first phase being dedicated to revitalization and reduction of sulfur emissions of the existing blocks of Kostolac B. Serbia had already taken a loan in the amount of \$293 million from the same bank for this first project phase.<sup>112</sup> Controversy about this contract developed, stemming from the stipulation in its terms that any dispute about the contract was to be settled through arbitration in Beijing, and that any ruling would be final, without right of appeal.

In 2017, Serbian representatives signed another contract with CMEC, this time in partnership with Power Construction Corporation of China. The contract was signed to build a facility for the processing and containment of waste water from central parts of the Belgrade while Yang Fen of the Power Construction Corporation of China signed a different contract to build a hot water pipeline running from the Nikola Tesla Thermal Power Plant (TENT) in Obrenovac to New Belgrade. Former Mayor of Belgrade, Siniša Mali stated that the value of the hot water pipeline is around 200 million USD.<sup>113</sup>

All of the mentioned projects are based on loans that Serbia took from Chinese banks (Exim Bank in particular), with Chinese companies also doing most of the construction. A common feature of all of these projects is that they are strategically important project in energy infrastructure for Serbia, and also important for China because of their role in the broader Belt and Road initiative that Chinese policymakers have claimed to be their long-term strategic plan.

Beside these, there are several other important ongoing projects that involve investments in existing Serbian businesses.

Smederevo Steel Plant is one of Serbia's main exporters. The formerly state-owned company was privatized during a transition period in the early 2000s. U.S. Steel acquired it in 2003 and ran it for 9 years. The Serbian government bought back Smederevo steel plant from U.S. steel

in 2012 for 1 USD due to accumulated debt and closure of several parts of the company. In 2016, after four years of unsuccessful attempts to find either a buyer or partner for the revitalization of Smederevo steel plant, the Serbian company leadership reached an agreement with Chinese HeSteel, which purchased the steel plant for 50 million USD.<sup>114</sup> Within the framework of the agreement, HeSteel (now HBIS) obliged to retain all of its 5000 workers, and to invest additional capital in the company. It was reported that HBIS has invested 120 million USD since then,<sup>115</sup> and in 2018 HBIS is planning to invest an additional 170 million USD between then and 2020.<sup>116</sup> In November 2018, Serbian Ministry of Finance reported that Smederevo Steel plant was the second biggest Serbian exporter in the first 9 months of 2018, with 650 million USD worth of exports.<sup>117</sup>

The year 2018 can be considered a peak for both announced and finalized Chinese investments in Serbia. The biggest finalized project was the takeover of Mining and Smelting Combine Bor (RTB Bor) by the Zijin Mining Group. In August of 2018 it was announced that the bid by Zijin Mining group was accepted over those of Russian Ugold and Canadian Diamond Fields.<sup>118</sup> Zijin offered 1,26 billion USD for a 63% of stake in RTB Bor, with an additional 200 million USD offered to cover existing debts. It has been agreed that all 5000 current workers will keep their jobs. By the end of 2018, Zijin Mining purchased a controlling package of Canadian Nevsun Resources Ltd., independent mining research company that has also been doing business in Serbia in the field of mining exploration<sup>119</sup>, including cooperation with RTB Bor mines. In December of 2018, it was announced that Zijin Mining and the Serbian government had finalized the acquisition deal for RTB Bor.<sup>120</sup>

## JOINT PROJECTS FOR THE FUTURE

During the Serbian government delegation's visit to China in September of 2018, which was personally headed by President Vučić, several investment projects have been agreed.

Former Mayor of Belgrade and current Minister of Finance Siniša Mali signed a contract with representatives of Shandong Linglong to invest 1 billion USD in three phases of construction of a new tire company in

111 *Preferential Buyer Credit Loan Agreement on Phase II of the Package Project Kostolac-B Power Plant between The Government of the Republic of Serbia Represented by the Ministry of Finance as Borrower and The Export-Import Bank of China as lender*, 17.12. 2014, available at: <http://www.parlament.gov.rs/upload/archive/files/lat/pdf/zakoni/2015/37-15%20lat.pdf?fbclid=IwAR22ucRYIlx89-UoP51AOzG9ua9ZJLHsMGUoCvIGJB5EVZy78K1TRRqx0PI>

112 Šarić, Milica; "Kostolac: Chinese loan, Serb rule-breaking"; *CINS*; 21.07.2016 (available at [https://www.cins.rs/english/research\\_stories/article/kostolac-chinese-loan-serb-rule-breaking](https://www.cins.rs/english/research_stories/article/kostolac-chinese-loan-serb-rule-breaking))

113 "Chinese company to build heating pipeline in Belgrade"; *Balkan Green Energy News*; 08.06.2017 (available at <https://balkangreenenergynews.com/chinese-company-to-build-heating-pipeline-in-belgrade/>)

114 *The sale and purchase agreement for certain assets of Železara Smederevo*, 2016, available at: [http://www.privreda.gov.rs/wp-content/uploads/2016/04/ASPA-FINAL-As-set-Sales-And-Purchase-Agreement-initialized\\_1.pdf](http://www.privreda.gov.rs/wp-content/uploads/2016/04/ASPA-FINAL-As-set-Sales-And-Purchase-Agreement-initialized_1.pdf)

115 "Yu: Zelezara's Profit in 2017 will be more than 20 million Euros"; 16.07.2017 (available at <http://www.hbissrbia.rs/index.php?link=en/news-view/1961/yu-zelezaras-profit-in-2017-will-be-more-than-20-million-euros>)

116 Ralev, Radomir; "China's HBIS to invest 150 mln euro in Serbian steel mill by 2020"; *SeeNews*; 02.07.2018 (available at <https://seenews.com/news/chinas-hbis-to-invest-150-mln-euro-in-serbian-steel-mill-by-2020-618465>)

117 "Finance ministry lists Serbia's biggest exporters"; *Beta*; 29.11.2018 (available at <http://rs.n1info.com/English/NEWS/a439881/Finance-ministry-lists-Serbia-s-biggest-exporters.html>)

118 "Chinese Zijin and Russian Ugold in the running for Serbian mining giant RTB Bor"; *BNE Intellinews*; 29.08.2018 (available at <http://www.intellinews.com/chinese-zijin-and-russian-ugold-in-the-running-for-serbian-mining-giant-rtb-bor-147568/>)

119 "Serbian exploration Projects"; *Nevsun*; (available at <https://www.nevsun.com/projects/exploration/serbia/>)

120 "Zijin Completes the Investment in RTB Bor Group"; *Zijin*; 21.12. 2018 (available at <http://www.zijinmining.com/investors/117926.htm>)

Zrenjanin, Vojvodina (northern Serbia).<sup>121</sup> It was said that Shandong Linglong chose Serbia over the Czech Republic, Poland, and Slovakia due to lower costs of production, lower energy costs and lower labor costs.<sup>122</sup>

As reported by Serbian news outlet B92, the Minister of Finance also signed an "Agreement on the purchase of equipment, works and services for the realization of a capital project of traffic surveillance between the Republic of Serbia and company Huawei".<sup>123</sup> Huawei has a strong presence in Serbia, with its headquarters for Balkans based in Belgrade. Other agreements with Huawei included technical cooperation in education<sup>124</sup>, and cooperation in security surveillance through Huawei's "Safe City Solutions" package, aimed at providing more secure surroundings for citizens.<sup>125</sup> It is worth noting that some other countries where Huawei has a notable presence, namely Poland and the Czech Republic, recently adopted different positions toward the presence of Huawei in their respective countries. With respect to Huawei's involvement in national 5G-network development, citing security concerns. These relate to questions of the potential for Chinese espionage and misuse of existing technologies. Huawei representatives were arrested in Poland,<sup>126</sup> and warnings about possible misconduct made in December 2018 by the Czech National Cyber and Information Security Agency (NCISA).

The Serbian government also signed a contract for the construction of an industrial park in Belgrade with CRBC that will be possibly inhibited with

new Chinese companies. The approximate value of the investment is 257 million USD, and the construction of the park should start in the spring of 2019.<sup>127</sup>

Earlier in 2018, Chinese automotive company Minth announced that it would be investing 100 million USD in the construction of a factory in Loznica, Western Serbia.<sup>128</sup>

Also in 2018, another Chinese company, automotive parts manufacturer Mei Ta, announced the beginning of the second phase of a project in Serbia, involving a 122 million USD investment in a second car parts factory in Obrenovac. During the first phase, Mei Ta invested around 65 million USD to construct the first factory.<sup>129</sup>

Table 1. Chinese FDI in Serbia - Major Characteristics

Main form of investment	Brownfield, M&A
Main Sector	Infrastructure, Energy, Wholesale and retail, automotive industry, heavy industry
Most important Chinese Companies	HeSteel (HBIS), Zijin Mining Group, Huawei, MeiTa, Bank of China, Shandong Hi-Speed Group Co., YTO Group Corporation
Company form of Investors	Both state-owned and private

## 4. OVERSIGHT AND CONTROL OF AGREEMENTS BETWEEN CHINA AND SERBIA

The increasing presence of Chinese companies in Serbia, the takeover of strategically important state-owned companies, and the signing of contracts between representatives of Serbia and China raise the question as to whether Serbia really has the means to fulfill the obligations it has agreed to in many financial agreements. It is also necessary to ask what consequences, whether good and bad, these agreements will bring.

The signed agreements and contracts, from September of 2018 and earlier, secure the presence of China in strategically valuable sectors of industry and the Serbian economy at large. The gravity of these

agreements means that it is in Serbia's interest that they are implemented and that the consequences are positive, at least in the short term.

Only a small number of agreements between Serbia and China (or Chinese companies) are accessible to the public. This is not an exclusive feature of agreements signed with China. The public in Serbia has experienced a lack of transparency in international agreements in the past (for example see cases such as the Belgrade Waterfront, Air Serbia, and Airport Nikola Tesla). Labels of public or business secrets most often prevent the public from inquiring into the details of signed contracts and other agreements

121 "Chinese Company to invest \$ billion in Serbia's north"; *Beta*; 17.09.2018 (available at <http://rs.n1info.com/English/NEWS/a420718/Chinese-billion-investment-into-Serbia-s-northern-town-of-Zrenjanin.html>)

122 "Serbia Chosen for modern tire factory"; *B92*; 23.08.2018 (available at [https://www.b92.net/eng/news/business.php?yyyy=2018&mm=08&dd=23&nav\\_id=104921](https://www.b92.net/eng/news/business.php?yyyy=2018&mm=08&dd=23&nav_id=104921))

123 "Serbia and China sign several important documents"; *B92*; 28.09.2018 (available at [https://www.b92.net/eng/news/business.php?yyyy=2018&mm=09&dd=18&nav\\_id=105087](https://www.b92.net/eng/news/business.php?yyyy=2018&mm=09&dd=18&nav_id=105087))

124 "Huawei becomes Serbia's strategic partner in education"; *B92*; 15.05.2019 (available at [https://www.b92.net/eng/news/business.php?yyyy=2017&mm=05&dd=15&nav\\_id=101269](https://www.b92.net/eng/news/business.php?yyyy=2017&mm=05&dd=15&nav_id=101269))

125 "Huawei Safe City Solution: Safeguards Serbia"; *Huawei*; 12.02. 2019 (available at <https://e.huawei.com/en/case-studies/global/2018/201808231012>)

126 Browne, Ryan; "Huawei employee arrested in Poland over spying allegations"; *CNBC*; 11.01.2019 (available at: <https://www.cnn.com/2019/01/11/poland-arrests-huawei-employee-over-spying-allegations.html>)

127 "China to build industrial park in Belgrade's suburb"; *B92*; 21.01.2018 (available at [https://www.b92.net/eng/news/business.php?yyyy=2018&mm=01&dd=21&nav\\_id=103257](https://www.b92.net/eng/news/business.php?yyyy=2018&mm=01&dd=21&nav_id=103257))

128 Kovačević, Tanja; "New plant in Loznica in sight"; *BizLife*; 05.10.2018 (available at <https://www.bizlife.rs/en/business/business-news/new-plant-in-loznica-in-sight>)

129 Ralev, Radomir; "China's Mei Ta to invest 100 mln euro in Second Factory in Belgrade"; *SEENews*; 23.01.2018 (available at <https://seenews.com/news/chinas-mei-ta-to-invest-100-mln-euro-in-2nd-factory-in-belgrade-mayor-599223>)

until their implementation, and even afterwards certain parts are often partially or fully redacted.

Additionally, the Serbian legislative framework states that every international agreement must be ratified in the National Assembly. However, this does not mean that they will go through the whole legislative procedure like ordinary legislation. Part of the overall international agreements that went through the ratification process were ratified through an exceptional “urgent procedure”. This means that the opportunity for any kind of public debate and discussion about the agreement is greatly reduced. The obstacles to debate are increased by the fact that the ruling party has a majority in the Assembly and thus there is very little chance for the agreement not to be ratified.

Serbia, as a candidate for membership in the EU, is trying to harmonize its legal framework and foreign policy, including foreign trade policy, with the EU’s policies. Through annual progress reports, the EU Commission evaluates the overall condition and current obstacles of Serbia’s journey towards EU membership. In a report published in May 2018, which covers the period from October 2016 to April 2018, it is stated that the Serbian Commission for the Protection of Competition is the body responsible for securing fair market competition. The Commission made its importance clear during the case of RTB Bor’s purchase by the Zijin Mining Group. The Commission had to approve the acquisition of RTB Bor after Zijin Mining Group won the public bid for it.

Unlike many EU member states, Serbia does not have a concrete screening mechanism to inspect whether foreign direct investments pose any threat to the security and public order of the country. However, different public officials have stated that every contract with China goes through some kind of approval by EU institutions. Also, EU laws and guidelines apply to Serbia-China agreements if the agreement includes a EU member state, for example the agreement to build a railroad between Belgrade

and Budapest. The European Commission inquired into how the terms of the agreement were negotiated, and ultimately accepted it. This process nonetheless slowed down the implementation of the contract, and work on the railroad. In the end, new contracts were signed and Hungary held a new public tender for the construction of the railroad.

Even though Serbia is still only a candidate for EU membership, the Serbian government has, to a certain degree, respected EU normative and legal frameworks in making and signing agreements with China.

According to Serbian law, implementation and oversight of these agreements is the responsibility of “public administration authorities in charge of the sector which is covered by the agreement”. Clauses of the agreement may additionally provide further stipulations on oversight and implementation control. This can be problematic, as in the case of a loan for the TPP Kostolac B power plant and the mining where any kind of disagreement is to be decided through arbitration in China, and will thus be subject to Chinese laws.<sup>130</sup> This has not been common practice when dealing with loans from other EU partners.

The signed agreements and contracts ensure that China can be expected to remain an active investor in Serbia and the Western Balkans. Oversight and control over the implementation of investment projects and other contracts are determined by Serbia’s legislative framework, by the necessity for harmonization with EU legal systems and Serbia’s aspiration for EU membership, and finally by the terms agreed to in the contracts themselves. The way in which control is actually exercised often depends on political decisions. The fact that Chinese companies are increasing their presence in strategically crucial sectors highlights the importance of potential control mechanisms. China enjoys a high level of support and cooperation with officials in Serbia; we presume this will remain unchanged in the near future.

## 5. CONCLUSION

China’s growing presence in Serbia has been well received, both by political elites and the general public. In recent years, Chinese companies took over several large, previously state-owned entities with large numbers of employees. Those companies, like the Smederevo steel plant or RTB Bor, employed a high percentage of local residents, therefore fears of those companies shutting down due to rising debts and the “salvation” that came with Chinese acquisitions had great impact on the positive image of China among the general public. This positive narrative was, of course, greatly aided by local elites, hoping to “rub off” success and gain political points.

In the short term, Serbia has received only positive incentives from China, on the local, national and international levels. Still, the possible consequences could be negative in the long term, if we look at the Chinese presence in terms of “debt trap diplomacy”, but at the moment this topic is not really being discussed.

It is fair to say that the attractiveness of Chinese loans is partially hidden in the fact they are easier to obtain than loans from international financial organizations because they usually do not come with the same conditions

<sup>130</sup> “Zakon o potvrđivanju ugovora o zajmu za kredit za povlašćenog kupca za drugu fazu paketa projekta kostolac-b power plant project između vlade republike Srbije, koju predstavlja ministarstvo finansija, kao zajmoprimca i kineske export-import banke kao zajmodavca”, 17.12. 2014 (available at: <http://www.parlament.gov.rs/upload/archive/files/lat/pdf/zakoni/2015/37-15%20lat.pdf?fbclid=IwAR22ucRYIlx89-UoP51AOzG9ua9ZJLHsMGUoCvIcGJB5EVZy78K1TRRqx0PI>)

like from the IMF or World Bank. These conditions usually entail some sort of terms involving democratic values, human rights, or worker's rights, whereas Chinese banks do not set those kinds of requirements. Yet, it shall be noted that this level of cooperation with China may come with certain risks. European countries are still the biggest trade partners of Serbia. Serbia's strategic goal is to become a full member of the European Union, and European countries have the biggest presence in Serbia in terms of investments and political influence. So, cooperation with China could be questioned, at the least. Besides money, there is also Serbia's political interest. China, as a permanent member of UN Security Council, is still providing support to the "Serbian cause" regarding the question of Kosovo's self-proclaimed independence. And in Serbia's eyes it is always useful to have a "strong friend" on its side.

Recently, the Chinese presence has become more visible. Statements coming from certain European representatives can illustrate this. Johannes Hahn, EU-Commissioner for European Neighborhood and Enlargement Negotiations, stated that Balkan countries could become "Trojan horses" for Chinese interests.

Still, stating that China's interest in Serbia is solely tied to the country's goals of reaching European markets through Serbia once Serbia becomes the EU member state is probably not accurate. It should be noted that stability of the political regime in Serbia gives China a sense of security and certainty that its business interests would not be endangered by political changes. Serbia also enjoys one of the lowest labor and energy costs in Europe, which may be attractive for potential investors. In addition, Serbia is well-positioned, located relatively close to several waterways and just on the border of the EU. With its ongoing infrastructure projects, China will ensure that its goods will be easily transported to the European and other markets included in BRI, like Africa and Asia through Serbia, and as such there is a broader underlying economic logic for its presence in Serbia.

The proclaimed "steel friendship" between Serbia and China will probably last for a considerable amount of time. China found a reliable partner in Serbia; it currently has good connections with the strongest political forces in the country and has positioned itself in strategically important projects and companies. Even though China is not Serbia's biggest trade partner or supporter in the field of international relations, it is a rising superpower and thus Serbia will likely try to keep its friendship with the "Middle Kingdom".

## SLOVAKIA

### WISHFUL THINKING: SLOVAKIA'S CHINESE DREAM

#### 1. SLOVAK RELATIONS WITH CHINA

The end of Cold War has caused a fundamental shift in Slovak foreign policy. After four decades of belonging to the “Eastern Bloc” of Communist puppet states under Soviet domination, Slovakia has set forth to re-establish itself as a member of the global West. Having gained both NATO and EU membership in 2004, it can be said that Slovakia managed to succeed in this goal.

This development has influenced Slovakia's relations with other non-Western countries, China included. By transferring a portion of its own competences to EU authorities, Slovak relations with China in such crucial areas as trade and investments are highly influenced by Brussels. This is most visible in the area of tariffs and other barriers to trade, which are exclusive competencies of the EU (i.e. Slovakia as an individual member state cannot set its own import tariffs, nor antidumping or countervailing duties on Chinese goods).

Nevertheless, after fulfilling its primary goal of re-establishing itself as a member of the West, Slovakia began to develop relations with other countries as well, China included. Impetus for developing relations with China was especially strengthened by the global financial crisis in 2008. While China is not a major priority of Slovak foreign policy, we can nonetheless observe a change in the approach towards China, which has resulted in Slovakia joining the 16+1 framework of cooperation in 2012, signing a Belt and Road Initiative (BRI) memorandum in 2015, and passing a China-specific policy document by the Government in 2017 – The Conception of Developing Economic Relations between Slovak Republic and People's Republic of China.<sup>131</sup> As the name of this document suggests, Slovakia sees Sino-Slovak relations mostly in economic terms, while neglecting to take into account the impact of increasing economic ties with China on its political and security interests.<sup>132</sup> An accompanying Action Plan,<sup>133</sup> according to which the Conception was supposed to be implemented, was not passed, however, due to lack of consensus among key ministries.

The lack of sensitivity on the part of Slovak politicians when it comes to security implications stemming from relations with China is best illustrated by recent developments surrounding the Huawei telecommunications company, which has been previously accused by many governmental institutions as well as security experts around the world of being complicit in corporate espionage for the benefit of the Chinese government. Nevertheless, according to Slovak Prime Minister Peter Pellegrini, Huawei does not present a security risk as he did not receive any official warning from the Slovak security and intelligence services.<sup>134</sup> What makes the statement quite peculiar and showcases the lack of sensitivity towards China-related security risks is the fact that just one month earlier, the spokesman of Slovak President Andrej Kiska said that the President's Office received a recommendation from the Slovak Intelligence Service to avoid using Huawei products.<sup>135</sup>

As will be further demonstrated in the following section, economic relations with China are marred by an ever-increasing negative trade balance on the part of Slovakia. Previous analysis by Institute of Asian Studies has shown that in order to improve economic ties with China, Slovak policy recognizes the following priorities:<sup>136</sup>

- attracting investments with high added value,
- supporting Slovak business in accessing the Chinese market,
- promoting tourism in Slovakia,
- developing so-far neglected political relations.

That being said, unlike some of its neighbors (Czechia, Hungary), the Slovak government did not engage in openly pro-Chinese or pro-active behavior (i. e. pro-actively taking actions which may be perceived as accommodating to Chinese interests). On some occasions, it went as far as engaging in behavior that could even be labeled provocative. This includes, for example, acceptance of ethnic Uyghur prisoners from the Guantanamo Bay U.S. military prison despite protests from Beijing, former

131 “LP/2017/203 Návrh Konceptia rozvoja hospodárskych vzťahov medzi Slovenskou republikou a Čínskou ľudovou republikou na roky 2017 – 2020”; *Slov-lex*; (available at <https://www.slov-lex.sk/legislativne-procesy/-/SK/LP/2017/203>)

132 Šimalčík, Matej; “Multilateralism as a tool in Slovak China policy: The case of 16+1, V4+China, and EU+China”; *Institute of Asian Studies*; 03.07.2018 (available at <http://www.asian.sk/multilateralism-as-a-tool-in-slovak-china-policy/>)

133 “LP/2017/654 Návrh Akčného plánu ku Konceptii rozvoja hospodárskych vzťahov medzi Slovenskou republikou a Čínskou ľudovou republikou na roky 2017 -2020”; *Slov-lex.sk*; (available at <https://www.slov-lex.sk/legislativne-procesy/-/SK/LP/2017/654>)

134 “Slovakia has no evidence of Huawei security threat - prime minister”; *Reuters*; 30.01.2019 (available at <https://www.reuters.com/article/us-usa-china-huawei-slovakia/slovakia-has-no-evidence-of-huawei-security-threat-prime-minister-idUSKCN1PO1TO>)

135 “Treba sa báť technológii Huawei? Prezidentovi SIS radila, aby sa im vyhýbal,” *Denník N*, 10.12.2018 (available at <https://dennikn.sk/1321588/treba-sa-bat-technologiei-huawei-prezidentovi-sis-radila-aby-sa-im-vyhybal/>)

136 Husenicová, Lucia, Kristína Kironská, Filip Šebok, Matej Šimalčík, Richard Q. Turcsányi; “Potenciál Novej hodvábnej cesty pre Slovensko”; Bratislava: Inštitút ázijských štúdií (2019).

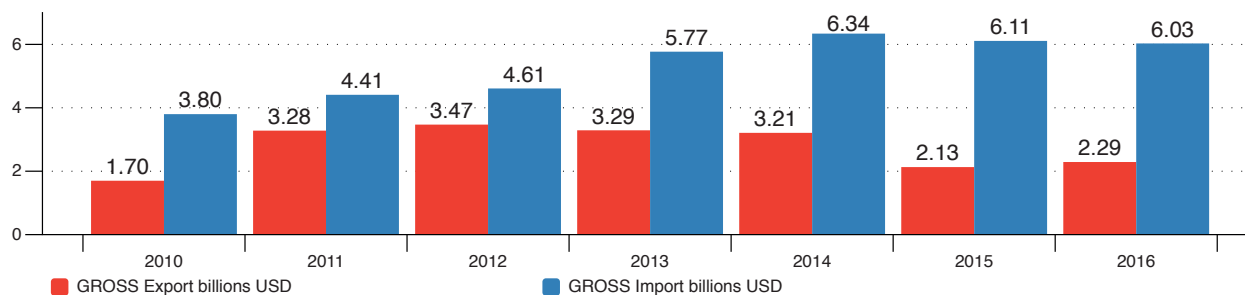


Prime Minister Robert Fico's skipping of the 2016 summit of the 16+1 forum in Suzhou, China, absence of any high-level Slovak representative at the 2017 Belt and Road Forum, or President Kiska's 2016 meeting with the Dalai Lama, which caused Chinese outrage.<sup>137</sup>

In developing relations with China, Slovakia is strongly focused on multilateral frameworks of cooperation. Developing relations on the

EU-China and 16+1 levels has been instrumental for Slovakia to develop relations with China. Moreover, on political issues, the Visegrad 4+China framework has proven somewhat useful as well. It is important for Slovakia to develop dialogue with China within all three multilateral formats, and not to rely solely on the 16+1 format, which was initiated by China itself.

Figure 7. Slovakia - China trade



Source: ATLAS OF ECONOMIC COMPLEXITY (AEC)

## 2. CHINESE ECONOMIC PRESENCE IN SLOVAKIA

### WISHING FOR INVESTMENTS

Since the "discovery of China" in 2009, Slovak politicians (especially PMs Fico and Pellegrini) often presented Slovakia as a potential investment hub for Chinese firms seeking to expand to Europe. This notion is highly detached from reality for two reasons. Chinese firms have already developed a much larger presence in western Europe than in CEE. Moreover, Central Europe has only little to offer to China (small markets, not that many homegrown high-tech firms to invest in, etc.) and as such is not well understood by Chinese actors, which reduces the investment appeal of the region.

So far, Slovakia has been a recipient of only mid-sized Chinese investments (by Slovak standards), and still awaits any large scale investment. This is reflected in the data on inward foreign direct investment. Of all the V4 countries, Slovakia has received the lowest amount of investments. The total stock of Chinese FDI in Slovakia amounted to 37.4 million USD as of 2016. This is also the lowest amount of FDI from any of the major

East Asian economies as well. Taiwan (86.2M USD), Japan (64.6M USD), and South Korea (3.3B USD) had each invested more in Slovakia as of 2016.<sup>138</sup> The accuracy of the data is, however, questionable, as FDI flows are notoriously difficult to measure. For example, the data released by the Chinese Ministry of Commerce (MOFCOM) valued Chinese FDI in Slovakia at 82.8 million USD. Nevertheless, MOFCOM also reported the lowest stock of Chinese FDI from among the V4 in Slovakia.<sup>139</sup>

Thus, it is safe to conclude that Slovak investment relations with China still exist mostly on the level of wishful thinking. However, there were several high-profile investment proposals made in the past that ultimately fell through. Most notable was a proposed investment in the U.S. Steel plant near Košice by the Chinese provincially-owned enterprise Hesteel. This transaction was valued at approximately 1.6 billion USD, with an estimated 1.1 billion USD in further investment to be made by Hesteel after the acquisition.<sup>140</sup> Even though the U.S. Steel and Hesteel signed a memorandum of understanding, the sale did not happen do to the

<sup>137</sup> Turcsányi, Richard Q.; "Fico pre rozvoj vzťahov s Čínou neurobil prakticky nič"; *Denník N*; 07.11.2016 (available at <https://dennikn.sk/602336/fico-pre-rozvoj-vztahov-s-ci-nou-neurobil-prakticky-nic/>); Šimalčík, Matej; "Multilateralism as a tool in Slovak China policy: The case of 16+1, V4+China, and EU+China"; *Institute of Asian Studies*, 03.07.2018 (available at <http://www.asian.sk/multilateralism-as-a-tool-in-slovak-china-policy/>)

<sup>138</sup> Data released by the Slovak National Bank.

<sup>139</sup> "2017 Statistical Bulletin of China's Outward Foreign Direct Investment"; *Ministry of Commerce of the PRC*

<sup>140</sup> Husenicová, Lucia, Kristína Kironská, Filip Šebok, Matej Šimalčík, Richard Q. Turcsányi; "Potenciál Novej hodvábnej cesty pre Slovensko"; Bratislava: Inštitút ázijských štúdií (2019).

increase of price on the U.S. side and supposed change in Chinese policy due to which Hesteel stopped all investing activities abroad.<sup>141</sup>

Another notable example was the proposed joint purchase of television station TV Markiza by Chinese CEFC China Energy (a conglomerate mostly active in petrochemical, energy, and financial sectors) and Czechoslovak investment group Penta. This investment plan failed to materialize mostly due to financial and legal troubles for the Chinese partner.

CEFC's activities deserve further discussion, as the conglomerate made headways in the Slovak banking industry when it joined forces with the joint Czech-Slovak investment group J&T. Originally, CEFC acquired a 5% share in J&T Finance, a holding company behind J&T Bank and Poštová Banka.<sup>142</sup> As time went on, CEFC planned to increase its stake in J&T Finance to an exceptionally high 50%. The transaction managed to receive approval from most banking regulators (Slovak National Bank and European Central Bank included), but in the end was stopped by the Czech National Bank, which cited the unclear origin of the money to be used for the transaction.<sup>143</sup> In the end, CEFC's debts to J&T needed to be settled by Chinese state-owned CITIC Group.

Nevertheless, we can also find several cases of successful Chinese investments. The most recent case occurred in the logistics sector at the end of 2017. The transaction included the sale of warehousing facilities of 240 thousand sqm. by logistics company Prologis to CNIC Corporation Limited, a Chinese state owned enterprise. The details about the value of the transaction remain unknown, however the transaction was described as the "largest transaction in the history of the logistics sector in Central and Eastern Europe."<sup>144</sup> However, this transaction is not reflected in the Chinese MOFCOM data at all, as it records only a 0.68 million USD year-on-year increase of FDI stock in 2017. This is most likely due to the structuring of the deal, as the only shareholder of CNIC vehicles in Slovakia is a Luxembourg-based company, Branton Holdings SARL.<sup>145</sup> According to some estimates, the Chinese firm paid around 113 million USD for the purchase.<sup>146</sup> This would make the CNIC acquisition by far the largest of all the Chinese investments in Slovakia.

Prior to the sale of Prologis warehouses, several smaller (or rather mid-sized by Slovak standards) investments took place. This included the

founding of local Huawei and Lenovo operation centers. In the automotive industry, several parts manufacturers established plants (SaarGummi, ZVL Auto, Heiland Sinoc Automotive, Inalfa Roof Systems, or IEEE Sensing Slovakia) and a research center (Mesnac European Research and Technical Centre) in Slovakia.<sup>147</sup>

Table 1: Chinese FDI in Slovakia – main characteristics

Main form of FDI	Brownfield, M&A
Main sectors	ICT, logistics, automotive, banking
Most important Chinese companies	Huawei, Lenovo, CNIC, CITIC (CEFC), various automotive companies
Company form of investors	private, state owned

## PROBLEMATIC TRADE IMBALANCE

Slovakia, like all other countries of Central and Eastern Europe, has a negative trade balance with China. The trend of a growing trade imbalance can be traced back to the structural reforms of the economy and liberalization of global trade regimes in 1990s and early 2000s (with China joining the World Trade Organization in 2001). That being said, Slovakia actually enjoys one of the more favorable trade balances with China in comparison with other countries in the region. To illustrate, while in the case of Slovakia the trade balance ratio of exports to imports was 1:4 in 2017, in the case of Poland it was as much as 1:12.<sup>148</sup>

Slovak exports to China steadily increased until 2011, when they peaked at approximately 2 billion USD. Becoming a member of the 16+1 framework and participating in the Belt and Road Initiative was intended to spark further growth in Slovak exports to China. But paradoxically, the opposite happened in the Slovak case, as since 2012 there is a decreasing trend in Slovak export volumes to China. In 2015, Slovak exports to China amounted to a little over half of what they were in 2012.<sup>149</sup> This decrease was caused by the drop in car exports from Slovakia to China, volume of which dropped from 3.05 billion USD in 2012 to 1.66 billion USD in 2016.<sup>150</sup>

Currently, Slovak exports to China represent only 1.6% of Slovakia's total exports. China is thus only in 14th place when it comes to export volumes by target country. Nevertheless, China is the largest export market for

141 Nemeč, Marek; "Zistenie HN: Predaj U. S. Steel padol. Košice budú americké"; *Hospodárske noviny*; 27.04.2018 (available at <https://hnonline.sk/hnbiznis/1735703-predaj-u-s-steel-padol-kosice-budu-americke>)

142 "CEFC sa stala 5% akcionárom J&T FINANCE GROUP SE"; *J&T Banka*; 13.05.2015 (available at <https://www.jtbanka.sk/o-banke/tlacove-spravy/1167641-cefc-sa-stala-5-akcionarom-jt-finance.html>)

143 Kušnírová, Michaela; "Česi nesúhlasia, aby CEFC získala väčší vplyv na materskú firmu Poštovej banky"; *SME Ekonomika*; 04.01. 2018 (available at <https://ekonomika.sme.sk/c/20730804/cesi-nesuhlasia-aby-cefc-ziskala-vacsi-vplyv-na-matersku-banku-postovej-banky.html#ixzz5GcmVZLIA>)

144 Kušnírová, Michaela; "Rekordný obchod: Číňania kúpili haly Samsungu či Tesca pri Galante"; *TREND.sk*; 28.09.2017 (available at <https://reality.etrend.sk/reality-biznis/rekordny-obchod-cinania-kupili-haly-samsungu-ci-tesca-pri-galante-2.html>)

145 See e. g. <http://www.orser.sk/vypis.asp?ID=413246&SID=7&P=0>

146 Husenicová, Lucia, Kristína Kironská, Filip Šebok, Matej Šimalčík, Richard Q. Turcsányi; "Potenciál Novej hodvábnéj cesty pre Slovensko"; Bratislava: Inštitút ázijských štúdií (2019).

147 Turcsányi, Richard Q.; "Chinese Financial Presence in Slovakia and Slovak 'China Policy'"; in Ágnes Szunomár, Chinese Investments and Financial Engagement in Visegrad Countries: Myth or Reality?, Budapest: Institute of World Economics (2014).

148 See chapter on Poland in this volume.

149 Husenicová, Lucia, Kristína Kironská, Filip Šebok, Matej Šimalčík, Richard Q. Turcsányi; "Potenciál Novej hodvábnéj cesty pre Slovensko"; Bratislava: Inštitút ázijských štúdií (2019).

150 "The Atlas of Economic Complexity"; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/stack/?country=206&partner=undefined&product=undefined&productClass=HS&startYear=undefined&target=Product&year=2016>)



Slovakia in Asia. This takes into account only goods exported directly from Slovakia to China. However, due to Slovakia's position in the global supply chain as an intermediary country, the actual exposure of Slovak economy to the Chinese market is approximately 3.5 times higher when re-exports are taken into account.

There have been repeated talks about promoting Slovak dairy exports to China. So far, Slovakia is one of the last EU members that does not have certification for its dairy products from Chinese authorities. At the end of 2018, Chinese veterinary inspectors visited Slovakia and inspected the facilities of its dairy producers. Should Slovak dairy producers receive Chinese certification, there is a possibility that Slovak dairy products such as yoghurts, cheese, or powdered milk will start to be exported to China.<sup>151</sup> However, this is only a marginal potential contribution to the Slovak economy as agriculture constitutes only a small share of overall Slovak exports and employment. Only some 3 % of Slovak workers are employed in the agriculture sector.<sup>152</sup> At most, agriculture constitutes 6.7% of overall Slovak exports.<sup>153</sup>

The structure of both Slovakia's exports to and imports from China has been largely immune to change over time in recent years (based on a comparison of data between 2012 and 2016).

A large share of Slovakia's exports to China are constituted by the Slovak automotive industry. Cars or car parts constitute as much as 70 to 80% of Slovak exports to China, according to various data sources.<sup>154</sup> Only a small portion of Slovak exports are made by small and medium enterprises.

Thus, the announcement made by Chinese Premier Li Keqiang at the Sofia summit of the 16+1 group in 2018 that China plans to lower the import tariffs on cars from 25 to 10% could improve Slovak car exports to China due to a lowering of prices for end consumers, thereby boosting demand.<sup>155</sup>

To summarize, Slovak exports to China are dominated by exports of transport vehicles (72.65%) followed by machinery (11.83%), electronics (9.52%), textiles and furniture (2.34%), chemicals and plastics (2.07%), metals (1.06%), agricultural products and wood (0.40%), and stone and glass (0.10%).<sup>156</sup>

When it comes to imports, imports from China represent some 8% of Slovakia's total imports. This makes China the third largest source of imports for Slovakia, after the Czech Republic and Germany.<sup>157</sup> The actual amount could be actually be much larger, as it recently came to light that Slovakia was a destination for Chinese textile exporters who deliberately undervalued their goods for the purposes of reducing the tariffs to be paid by them.<sup>158</sup> Based on the data from OLAF, the European anti-fraud agency, it can be estimated that some 3.4 to 4.5 billion USD worth of trade could be missing from the official trade statistics.<sup>159</sup>

The composition of imports from China is much more diverse than that of exports to China. The largest grouping of imported products is electronics (46.13%) followed by machinery (29.29%), textiles and furniture (12.65%), metals (4.42%), chemicals and plastics (2.64%), transport vehicles (2.16%), agricultural products and wood (1,73%), and stone and glass (0.86%).<sup>160</sup>

### 3. SLOVAKIA AND THE EU INVESTMENT SCREENING MECHANISM<sup>161</sup>

Foreign investments are typically perceived as an opportunity for a country to further develop its economy. However, the security risks which some types of investments can carry are not discussed as often as the possible gains. Investments in critical infrastructure and critical sectors

of the economy, such as energy and advanced dual-use technologies, are particularly sensitive and require careful consideration of attendant security implications. If such businesses get into the hands of an investor with ulterior motives, their acquisition may pose a security threat to the state.

151 "Šéf Slovenského mliekarenského zväzu S. Voskár o vývoze mlieka"; *TA3*; 01.02.2019 (available at <https://www.ta3.com/clanok/1147226/sef-slovenskeho-mliekarenskeho-zva-zu-s-voskar-o-vyvoze-mlieka.html>)

152 "Na čom stojí Pellegriniho čínsky sen"; *Institute of Asian Studies*; 28.10.2018 (available at <http://www.asian.sk/na-com-stoji-pellegriniho-cinsky-sen/>)

153 „The Atlas of Economic Complexity”; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/stack/?country=206&partner=undefined&product=undefined&productClass=HS&startYear=undefined&target=Product&year=2016>)

154 Husenicová, Lucia, Kristína Kironská, Filip Šebok, Matej Šimalčík, Richard Q. Turcsányi; "Potenciál Novej hodvábenej cesty pre Slovensko"; Bratislava: Inštitút ázijských štúdií (2019)

155 "Pitfalls of Slovakia's Chinese dreams," *Asia Dialogue*, 28.08.2018 (available at <http://theasiadialogue.com/2018/08/28/pitfalls-of-slovakias-chinese-dreams/>)

156 „The Atlas of Economic Complexity”; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/stack/?country=206&partner=undefined&product=undefined&productClass=HS&startYear=undefined&target=Product&year=2016>)

157 Husenicová, Lucia, Kristína Kironská, Filip Šebok, Matej Šimalčík, Richard Q. Turcsányi; "Potenciál Novej hodvábenej cesty pre Slovensko"; Bratislava: Inštitút ázijských štúdií (2019).

158 "Podvody na clách z Číny pokračujú tempom zhruba 7 miliónov eur mesačne," *Denník N*, 20.09.2018 (available at <https://dennikn.sk/minuta/1236636/>)

159 "The OLAF Report 2016"; *Luxembourg: Publications Office of the European Union*, 2017.

160 „The Atlas of Economic Complexity”; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/stack/?country=206&partner=undefined&product=undefined&productClass=HS&startYear=undefined&target=Product&year=2016>)

161 Šimalčík, Matej; "When investments are not in state interest"; *Institute of Asian Studies*; 15.12.2018 (available at <http://www.asian.sk/en/when-investments-are-not-in-state-interest/>)

## TRUST, BUT VERIFY

In order to ensure the protection of strategic industries, the EU Parliament (February 14, 2019) and EU Council (March 5, 2019) passed a regulation establishing a screening mechanism, which would enable the Commission and the Member States to examine investments from outside the EU in terms of potential security threats and would allow Member States to block them on security grounds. It is no secret that the European legislators' motivation is to defend the European market against Chinese investors in particular.

The proposal published by the Commission envisages the creation of two types of screening mechanism which will operate both nationally and at the EU level. The bulk of the investigative process falls within the competence of the Member States, which have the possibility to verify the impact of any investment project coming from outside the Union on their security and public order. It is left to the discretion of each Member State to determine the rules for the operation of their respective national system. A Member State can even decide not to establish such a mechanism at all. In case the state would not establish a mechanism, it would at least have the obligation to regularly inform the Commission on investments having been made in the country during the past year. At the same time, Member States must inform each other whenever they are investigating any investment so that other EU members can comment on the potential investment.

Simultaneously, a Commission screening mechanism will also be established. This mechanism will only deal with those cases in which the safety of projects of an EU-wide importance might be impacted (such as the Galileo and Copernicus satellite systems or trans-European networks), or with projects the implementation of which might affect the safety of several Member States. The Commission mechanism therefore has a considerably reduced scope compared to the national mechanisms. Commission scrutiny can be considered a safeguard for cases in which an investment would have a security impact on most or the whole of the Union, but the Member State in which the investment is to be realized would not be able or would not be willing to take into account the security aspects of the investment plan.

If it is found, based on an investigation conducted by either the Commission or a Member State, that an investment does indeed present a security threat, its implementation may be forbidden. However, only the Member State in which the investment will take place has the competence to decide to do so. On the other hand, if the Commission recommends that the State bans the investment on the basis of its own verification process (it concerns only projects of pan-European significance), and the State decides not to do so, the State must explain its differing position.

The purpose of the screening mechanism is neither to ban all investments in risk sectors from outside the EU, nor to allow large Member States to veto any investments from China into the smaller Member States, as some wrongly assume. The purpose of investment screening is to ensure that strategic enterprises and infrastructure will not get into the

hands of investors, in whose case there is a significant risk of their abuse (for example, it concerns investors under the control of a third country government) or any activity contrary to the security interests of the country and the EU. Nonetheless, achieving this goal does not necessarily mean that the investment in questions needs to be banned. In many cases, adoption of precautionary measures, such as dividing the enterprise being sold in a way which would ensure that the sensitive technologies would be sold to an EU-based investor, while the rest of the firm would be sold to a non-EU investor, might be sufficient.

Absolutely rejecting Chinese investments or naively welcoming them are both problematic stances. As written in the joint position of the Ministries of Economy and Finance,<sup>162</sup> these Ministries are not interested in Slovakia screening foreign investments. The Ministries perceive as positive the fact that the Member States are not required to adopt a screening mechanism for foreign direct investments, nor are they required to conduct any exhaustive substantive or procedural elements of the screening mechanism. Thus, the official stance of Slovakia is much closer to the latter extreme, namely that the country is being too welcoming.

Such a stance is problematic for two reasons. First of all, it unilaterally assumes that all foreign investments are a net benefit to the country. However, not too long ago, the Czech media and, to a lesser extent, the Slovak media were busy covering the topic of the investments of Chinese company CEFC, which came under the de facto control of the Chinese state, with many analysts seeing them as a tool for expanding Beijing's political influence in Prague.

The second problem is that an effective screening mechanism requires synergy between the EU and national mechanisms. Since the EU one should only deal with the impact of investments in projects of a pan-European importance, its contribution to the security of the Member States is not great. The activities of the already mentioned CEFC in the Czech Republic and Slovakia, would not be considered projects of pan-European importance, and therefore they would not be subject to scrutiny by the Commission, but only by the national governments of the directly-affected countries.

## PROTECTING AGAINST MALICIOUS INVESTMENTS WITHOUT SCREENING MECHANISM

In case Slovakia decides not to establish an investment screening mechanism, existing Slovak laws can supplement it only partially. For example, the regulations (largely harmonized within the EU) on banking, public procurement or media law provide a degree of protection against problematic investments. The partial protection provided by these regulations is best illustrated by the following examples.

The case of the increase in the shareholding of the Chinese CEFC in J&T Finance Group (the parent of J&T Bank and Poštová Banka) is interesting in this regard. Since 2015, CEFC has had an almost 10% share in the J&T

<sup>162</sup> "PI/2018/10 Riadne predbežné stanovisko Slovenskej republiky k Návrhu nariadenia Európskeho parlamentu a Rady, ktorým sa stanovuje rámec na preverovanie priamych zahraničných investícií do Európskej únie"; *Slov-lex*; (available at <https://www.slov-lex.sk/legislativne-procesy/-/SK/PI/2018/10>)

Finance Group. However, ongoing negotiations to increase the CEFC's share to 50% have been blocked by the Czech National Bank, which rejected the CEFC's request to grant approval to acquire a controlling share, citing the CEFC's inability to prove where their financial resources came from, which caused the regulator to have "reasonable concerns". Since the Czech National Bank did not grant permission, the transaction could not continue.

The public procurement rules also provide a degree of control over investment. One example is the construction of the Hungarian part of the railway between Budapest and Belgrade. It was originally expected that the construction, which is part of a project funded largely by China's Exim Bank, will be dealt with by Chinese companies. However, the Commission's investigation into possible breaches of public procurement directives has ruled it necessary for the Hungarian Government to launch a public tender, to which both Chinese and European companies have responded. More than thirty companies have shown an interest in the construction of the railway.

Regarding the protection of free media against the influence of authoritarian countries, there is a certain level of protection in the form of a cross-ownership ban that applies in Slovakia. In practice, it means that it is forbidden for television broadcasters, radio broadcasters and the national press to be interconnected by property or personnel. If the joint acquisition of TV Markíza by the Penta group and the Chinese CEFC was to take place, the CEFC (or the persons it is connected to) would no longer be able to buy any Slovak radio or newspapers. However, in practice, this safeguard is a toothless tiger (Penta is already a member of News & Media Holding owning several Slovak print media). The fact that the media need to be

protected not only from oligarchization, but also from foreign influences, is also being proven by CEFC's activities in the Czech Republic. Project ChinfluencE, which analyzes Chinese economic and political influence in the V4, found out that after the Chinese company bought the Barrandov television and the magazine Týden, both media began to report on China in an exclusively positive manner.<sup>163</sup> The Slovak Markíza TV station faced a similar threat, and in this case, influence on one particular media outlet would not be prevented even by the cross-ownership ban, since it only constitutes an obstacle to extending influence to multiple outlets.<sup>164</sup>

These examples demonstrate that Slovakia is not completely defenseless against the negative impact of investments on its security. In the right hands, already-existing tools can prevent the spreading of negative influence. However, it would be inappropriate to rely only on these instruments while not establishing any national investment screening mechanism. Such a mechanism, in contrast to existing instruments, can assess security threats of foreign investors in their entire complexity.

For the Slovak investment screening mechanism to function effectively, its establishment alone will not be enough. It must be provided with adequate means for its functioning and high-quality personnel who will understand not only the economic side of the issues, but also the issue of international and national security, and hybrid threats and interconnections between firms and the state in authoritarian countries such as China and Russia.<sup>165</sup>

Brussels has already woken up, and problematic investments are being discussed in European institutions. Hopefully, Slovakia and its government will also wake up before it is too late.

## 4. CONCLUSION

From among all the members of the V4, Slovakia has the least developed relations with China. Even though Slovakia joined the 16+1 platform and signed a BRI Memorandum of Understanding, it failed to attract any substantial Chinese investments or to improve its trade balance with China. On the contrary, in the past years we have witnessed several high profile negotiations with Chinese investors to fall through. Moreover, Slovak trade balance with China became even more negative as Slovak exports to China plummeted while at the same time Chinese exports to Slovakia kept rising.

Even though there were attempts on part of Slovak institutions to form a complex China policy, these have failed due to disagreements between

key ministries, mostly the Ministry on Foreign and European Affairs on one side with Ministry of Economy and Ministry of Finance on the other side.

Moreover, with its small market, Slovakia is not a particularly attractive country for expansion activities of Chinese companies. Thus, rather than hoping for substantial Chinese investment, the government should focus mostly on promoting Slovak exports to China, which would be a more promising endeavor. Moreover, as majority of Slovak trade with China is conducted indirectly (e. g. as re-exports of products through Germany), Slovakia should be more active in the EU debates on common EU policy on China, to achieve better results in this sphere as well.

<sup>163</sup> "Analýza médií"; *ChinfluencE*; (<http://www.chinfluence.eu/cs/analyza-medii/>)

<sup>164</sup> Šimalčík, Matej; "Čínska hrozba pre Markízu?"; *Denník N*; 27.11.2017 (available at <https://dennikn.sk/954201/cinska-hrozba-pre-markizu/>)

<sup>165</sup> Turcsányi, Richard Q., Šimalčík, Matej; "Čína na Slovensku: Sme pripravení na budúcnosť?" Praha: *Asociace pro mezinárodní otázky*, Bratislava: Inštitút ázijských štúdií, (available at [http://www.asian.sk/cina\\_na\\_slovensku\\_sme\\_pripaveni\\_na\\_buducnost/](http://www.asian.sk/cina_na_slovensku_sme_pripaveni_na_buducnost/))

The overall lack of vision when it comes to dealing with China means that Slovakia is not only unable to achieve major positive results from relation with China, but also is unprepared to deal with any accompanying risks. While the entire EU is embroiled in a debate on how to manage security risks and other political implications connected with economic relations with China, this debate is dormant in Slovakia. Due to lack of sensitivity of Slovak political elites towards Chinese actions in Europe, it appears that Slovakia will not pursue establishing of a robust investment screening mechanism and will implement only the bare required minimum of the EU FDI screening regulation.

## CZECH REPUBLIC

### SOBER ANALYSIS OF CZECH-CHINESE TRADE AND INVESTMENT TIES

The last decade has been characterized by increasingly fatalistic language about China's rise as a global economic superpower. Politicians across Central and Eastern Europe appear eager to pledge their support for Chinese ambitions. But any meaningful analysis of this situation must take into account the difference between political rhetoric and empirical outcomes. This chapter reviews the current state of economic and political relations

between China and the Czech Republic, with a focus on the most significant developments of the last few years. Overall, China retains a fairly limited role in the Czech Republic, and trade and investment data do not suggest that this has changed significantly in recent years. A number of cases of Chinese investment are reviewed in detail to provide insight into their motivations for entering the Czech market, and how they have performed since then.

## 1. CZECH RELATIONS WITH CHINA

Having one of the most open investment frameworks in the EU and a highly industrialized economy, the Czech Republic is naturally positioned as an attractive partner vis-à-vis China. As outlined in the 2015 foreign policy concept of the Czech Republic, "China represents one of the largest world economies and an important actor in dealing with problems of global significance. For this reason, the Czech Republic seeks to benefit from mutual political dialogue, which will enable deepening cooperation in a wide range of sectors, including economy, science and research, culture and human rights".<sup>166</sup> This strategic document thus clearly acknowledges that economic cooperation with China is regarded as playing an important role in forming and strengthening the bilateral relationship.

Prior to becoming a member of the EU, the political relations between the Czech Republic and China were in the 1990s largely influenced by former Czech President Václav Havel, whose extraordinary contacts with the Tibetan leader Dalai Lama, in addition to positive relations with Taiwan, were often interpreted by Chinese officials as weakening Chinese territorial integrity. Despite the rise in economic turnover since 2004, there was very little correlation in political relations, with the exception of some attempts between 2004 and 2006, when the top political echelons were represented by President Václav Klaus and Prime Minister Jiří Paroubek, who attempted to push for more intensive cooperation with China. However, these tendencies were relatively short-lived and the Czech Republic has generally been regarded among the EU member countries as one of the most critical towards China.

A crucial change occurred in 2013, as the new Czech government headed by the Social Democrats and new president Miloš Zeman set the improvement of bilateral relations as a key priority on their agenda. Simultaneously, there was imminent interest in national policy change from business circles, namely the Czech investment group PPF, which had vested interests in the Chinese market with consumer loans. As the Chinese President Xi Jinping

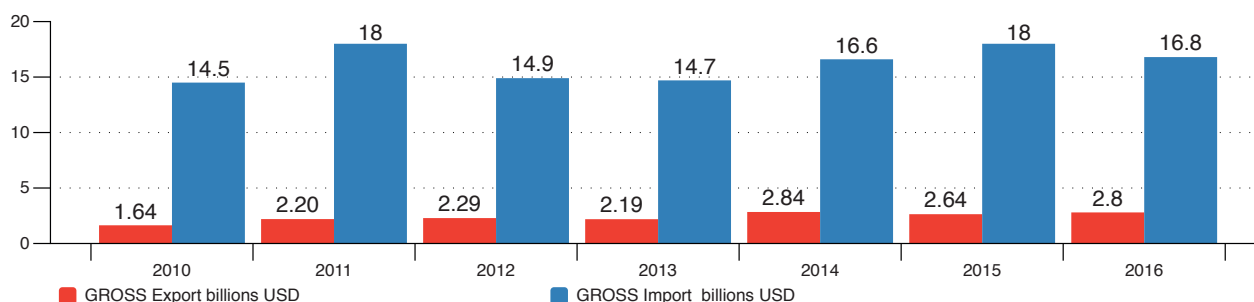
made the first visit by a Chinese head of state to the Czech Republic in March 2016, Sino-Czech ties gained symbolic momentum because these two countries signed an agreement on strategic partnership, whose aim was to deepen bilateral relations (interestingly, for example, Poland and China lifted their ties to a strategic partnership already in 2011).

Moreover, the Czech Republic is a part of the "16+1" initiative created in 2012 in Warsaw, which brings together 16 CEE countries and China. From the Czech standpoint, it serves the purpose of having an extra vehicle that can be used to strengthen bilateral ties, especially in areas such as civil aviation and medicine, among others. It also complements the work of main framework for dialogue with China that takes the form of strategic partnership between the EU and PRC. Recently, however, the "16+1" initiative has been criticized for undermining the EU's efforts of having a united foreign policy towards China.

<sup>166</sup> "Koncepte zahraniční politiky"; Ministerstvo zahraničních věcí České republiky; 13. 07. 2015 (available at [https://www.mzv.cz/jnp/cz/zahranicni\\_vztahy/analyzy\\_a\\_koncepce/koncepce\\_zahranicni\\_politiky\\_cr.html](https://www.mzv.cz/jnp/cz/zahranicni_vztahy/analyzy_a_koncepce/koncepce_zahranicni_politiky_cr.html))



Figure 8. Czech Republic – China trade



Source: ATLAS OF ECONOMIC COMPLEXITY (AEC)

## 2. CZECH REPUBLIC – CHINA TRADE

Before Czech Prime Minister departed for the 16+1 summit in July 2018, which he attended for the first time, he noted that the Czech Republic imports 10 times more from China than it exports. This acknowledgment, in fact, reflected a long-term trend in mutual trade relations, which is characterized by a chronic, massive imbalance.<sup>167</sup> Given China's position as a global manufacturing powerhouse, such asymmetry is, however, not uncommon among Central and Eastern European countries, where imports are uniformly significantly larger than exports.

In 2012 the Czech Republic's imports from China amounted to approximately 14.9 billion USD, while two years later trade developments showed an upswing and reached the value of 16.8 billion USD. In 2015 gross imports further increased to 18 billion USD, which represented the highest one-year growth figure since the 2001, when imports from China crossed the threshold of one billion USD for the first time. However, in 2016 gross imports fell to roughly the same level observed in 2014.

To illustrate the disproportionality on the export side, it is worth highlighting that in the period of 2011 to 2013 exports were roughly 2.2 billion USD. This figure increased to 2.84 billion USD in 2014, but a year later dropped to 2.64 billion USD. In 2016 the Czech Republic's exports to China hovered once again around 2.8 billion USD. Based on these observations it is fair to claim that mutual trade with China is generally rising, yet the disparity between import and export volumes remains a constant.

In light of these evolving phenomena, it is relevant to draw attention to the fact that the Czech Republic's most important trading partners all come from the EU. In 2017, the share of Czech exports destined for the EU was 83.7%.<sup>168</sup> Germany plays an especially prominent role in this regard. Over 30% of exports are destined for this market.<sup>169</sup> Moreover, all ten of the largest export partners are EU countries. Thus, to put it simply, trade with China is growing<sup>170</sup>, but it can hardly be compared with the significance of the EU market, which occupies a dominant position. This is true even when re-exports are accounted for because at least part of the sub-components exported to Germany are later part of products ending up on the Chinese market (particularly automobiles). The volume of these re-exports is difficult to determine, but in 2015 it was estimated that it might be as high as 2.25 million USD.

Unpacking trade data a little further provides a glimpse into the composition of Sino-Czech trade. From the perspective of exports, the major driver of growth is the automotive industry. Within this sector in 2016 parts of motor vehicles alone constituted 12.7% of total exports. The next largest sector was machinery and specifically pumps for liquids, which contributed 4.76% of total exports.<sup>171</sup> Meanwhile, imports from China predominantly consist of computers (28.30% of imports in 2012, and 21.13% in 2016) as well as a growing volume of transmission apparatus for radio, telephone and TV (6.10% in 2011, and 11.53% in 2016).<sup>172</sup>

<sup>167</sup> "16+1. Babiš míří na summit evropských zemí s Čínou"; *Tyden*, 07.07.2018 (available at [https://www.tyden.cz/rubriky/domaci/16-1-babis-miri-na-summit-evropskych-zemi-s-cinou\\_487770.html](https://www.tyden.cz/rubriky/domaci/16-1-babis-miri-na-summit-evropskych-zemi-s-cinou_487770.html))

<sup>168</sup> "Vývoz do Evropské unie roste, Česko nejvíce obchoduje s Němci"; *Novinky.cz*; 27.09.2016 (available at <https://www.novinky.cz/ekonomika/415930-vyvoz-do-evropske-unie-roste-cesko-nejvice-obchoduje-s-nemci.html>)

<sup>169</sup> "Český export loni dosáhl rekordních 4,2 biliónu. Víc vyvážíme do Německa I Číny"; *Novinky.cz*; 16.02.2018 (available at <https://www.ceskenoviny.cz/zpravy/csu-cesky-export-loni-dosahl-rekordnich-4-2-bilionu-korun/1582028>)

<sup>170</sup> "Analýza AMSP ČR: Obchodní a investiční a specifické aktivity mezi ČR a Čínou"; *Asociace malých a středních podniků a živnostníků ČR*; 23. 9. 2016 (available at [www.amspace.cz/uploads/dokumenty/2016/TZ/Analýza\\_obchodnich\\_a\\_investicnich\\_aktivit\\_mezi\\_CR\\_a\\_Cinou\\_2.pdf](http://www.amspace.cz/uploads/dokumenty/2016/TZ/Analýza_obchodnich_a_investicnich_aktivit_mezi_CR_a_Cinou_2.pdf))

<sup>171</sup> "The Atlas of Economic Complexity"; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/?country=59&partner=43&product=undefined&productClass=HS&startYear=undefined&target=Partner&year=2016>)

<sup>172</sup> "The Atlas of Economic Complexity"; *Center for International Development at Harvard University*; (available at <http://atlas.cid.harvard.edu/explore/?country=59&partner=43&product=undefined&productClass=HS&startYear=undefined&target=Partner&tradeDirection=import&year=2016>)

### 3. INVESTMENTS

Since the turnaround of Sino-Czech relations in 2014, which was spurred by significant political support and on both sides precipitated a series of high-level visits, a large share of have been devoted to the level of Chinese investments. Ambitious investment plans set early in the beginning of this so-called “restart period” caused uncertainty among observers of Sino-Czech developments, but the plans ultimately proved largely unrealistic, which then resulted in a phase of more sober expectations.

It should be noted that its strong industrial tradition, favorable geographical location and efficient subcontracting production network have arguably always worked in Czech Republic’s advantage. But the expansion of Chinese entities into the Czech Republic since 2014 would not have generated the fanfare it did were in cooperation with deep political and business ties.

In light of this reality, it is worth highlighting that despite the recent attention given to Sino-Czech relations, historically other Asian economies are much more important investment partners for the Czech Republic. In 2016, based on data provided by the Czech National Bank, FDI stock from China only totaled 665 million USD, while South Korea (2.84 billion USD) and Japan (1.66 billion USD) are among more traditional investors with long-standing bilateral ties that continue to make up a substantially larger share of total investments.<sup>173</sup>

Chinese investments in the Czech Republic have though increased markedly in the last five years. Nevertheless, the benefits realized are a matter of what kind of investments targeted the Czech market and whether they had a real added value in the form of creating job opportunities and spurring economic growth. In this particular case, a notable share of investments took the form of mergers and acquisitions instead of greenfield and brownfield projects.

When Chinese President Xi Jinping made the first visit by a Chinese head of state to the Czech Republic in March 2016, Czech President Miloš Zeman made the announcement that by the end of 2016 Chinese investments would reach the value of 4 billion USD.<sup>174</sup> In addition, a package of investment memorandums and agreements with a total value of 8.37 billion USD for the period 2016-2020 was signed. These ambitious calls quickly led to skepticism as to whether such promises could really be fulfilled. The sudden change in the Czech position also created a negative image around Chinese investments from the standpoint that the Czech Republic’s cozying up to China’s regime appeared to be a form of betrayal

of its long-standing criticism of Chinese human rights violations built under former President Václav Havel.

Since 2014, President Zeman has visited China five times times (in April 2019 he participated in the second Silk Road – Belt and Road Forum); attracting Chinese investments has been one of Zeman’s main economic objectives. These visits were previously accompanied by prominent figures from the Social Democrat-led centre-left coalition government that was in power until October 2017.

Following the parliamentary elections in 2017, the approach adopted by Prime Minister Babiš has been much more cautious. Although PM Babiš has been disinclined to make critical statements on China due to an undeclared political alliance with President Zeman, it may be assumed that PM Babiš is rather keen to develop relations with Chinese businesses on a more limited role focused on business-to-business relationship. Prior to becoming involved in politics, it should be acknowledged that he was not successful in investing on Chinese market in early 2000s.

By publicly welcoming Chinese capital, the Czech leadership was basically pursuing two strategies – attracting investment from Chinese entities with high added value, especially brownfield and greenfield investments, and providing more favourable conditions for Czech entities seeking access to the tightly-controlled Chinese market. The Chinese market as part of the broader Asian economy is perceived as having substantial potential, but entry requires a coherent strategy and long-term planning.

While there have been hopes in recent years that strong political support will contribute to Czech businesses’ entry into the Chinese market, only a small number of Czech companies have succeeded. Among the largest investors successfully entering the Chinese market was Petr Kellner, the Czech Republic’s richest man, who is heavily involved in the Chinese consumer credit market through his investment group PPF and specifically the company Home Credit. Such activities carry high business risk because licenses for providing loans need to be secured from the Chinese government on a regular basis, which may be difficult to achieve without continued support for deepening bilateral relations. However, it should be noted that PPF has operated on the Chinese market since 2007, so its activities do not necessary coincide with changes in Czech government policy vis-à-vis China.<sup>175</sup>

173 “STAV PŘÍMÝCH ZAHRANIČNÍCH INVESTIC V ČESKÉ REPUBLICE k 31.12. - podle principu směru, Jednotlivé země (princip bezprostředního investora)”; ČNB; 22.03.2016 (available at [https://www.cnb.cz/analytics/saw.dll?PortalGo&PortalPath=%2Fshared%2FPZI\\_WEB%2FWEB\\_PZI&Path=%2Fshared%2FPZI\\_WEB%2FPZI\\_BPM6\\_3.1.%20Stavy\\_T\\_Zem%C4%9B&Style=CNB&Done=Dashboard%26PortalPath%3D%252Fshared%252FPZI\\_WEB%252FWEB\\_PZI%26Page%3DPZI\\_%25C4%258CR%26ViewState%3Dm9fn5nfrkubl6g38alnb7co2ke&Action=Prompt&ViewState=m9fn5nfrkubl6g38alnb7co2ke&P16=NavRuleDefault&NavFromViewID=d%3Adashboard~p%3Agmdgrelm1ou5sg4f](https://www.cnb.cz/analytics/saw.dll?PortalGo&PortalPath=%2Fshared%2FPZI_WEB%2FWEB_PZI&Path=%2Fshared%2FPZI_WEB%2FPZI_BPM6_3.1.%20Stavy_T_Zem%C4%9B&Style=CNB&Done=Dashboard%26PortalPath%3D%252Fshared%252FPZI_WEB%252FWEB_PZI%26Page%3DPZI_%25C4%258CR%26ViewState%3Dm9fn5nfrkubl6g38alnb7co2ke&Action=Prompt&ViewState=m9fn5nfrkubl6g38alnb7co2ke&P16=NavRuleDefault&NavFromViewID=d%3Adashboard~p%3Agmdgrelm1ou5sg4f))

174 “Zeman: Čína letos v Česku investuje 95 miliard”; *Novinky.cz*; 29.03.2016 (available at <https://www.novinky.cz/ekonomika/398846-zeman-cina-letos-v-cesku-investuje-95-miliard.html>)

175 Kahn, Michael; “Czech finance firm banks on bumper borrowing in China”; *Reuters*; 18.10.2017 (available at <https://www.reuters.com/article/us-czech-home-credit/czech-finance-firm-banks-on-bumper-borrowing-in-china-idUSKBN1CN1C1>)



## CEFC – THE MOST NOTABLE INVESTMENT PROJECTS

One of the most visible and contentious Chinese investors in the Czech Republic has been Shanghai-based China Energy Company Limited (CEFC), which in 2015 chose Prague as the centre for its European operations. CEFC worked to further China's strategic interest in the Czech Republic, fostering good relations with the top echelons of the Czech political elite. Supporting the expansion of a greater number of Chinese companies in Central Europe and acquiring assets relevant for the development of the Chinese economy was considered another goal of the company.

In recent years CEFC China Energy has succeeded in building itself into the sixth largest Chinese private company. It made a series of foreign acquisitions in the oil and financial sectors outside of the Czech Republic, including Georgia, Kazakhstan and the United Arab Emirates. In addition, in 2017 it purchased a 14% stake in Russian oil conglomerate Rosneft.

Since early 2018 CEFC Chairman Ye Jianming, who had since 2015 been an advisor to President Zeman and is officially still serving in that role, has been under investigation by Chinese authorities. These investigations have arguably been motivated by large outstanding debts and a scandal connected to New York-based CEFC employee Patrick Ho, who was implicated in bribing officials from Chad and Uganda. The company's serious financial problems since the arrest of its founder have affected the company's activities in the Czech Republic. Relatively unknown until recently, much of CEFC's rise and the reasons for its current stumble remain murky.

In June 2018, the Czech anti-monopoly office UOHS has cleared Chinese state-owned CITIC Group's takeover of most of the Czech-based assets held by struggling CEFC,<sup>176</sup> this development has been presented by government officials and other interested stakeholders as the entry of a new, prosperous investor. CITIC also paid a debt of around 510 million USD it owed to Slovak-Czech J&T Finance Group, and the two entities have agreed to continue cooperation, including to jointly develop further business projects.<sup>177</sup> In order to expand its European activities, CITIC Group established a subsidiary CITIC Europe in Prague.

Since entering the Czech market, CEFC has focused its investments in real estate, as well as purchases of already-functioning companies with a wide range of interests. But the company did not necessarily invest in progressive technology or greenfield projects. Instead its focus could mostly be described as the collecting of established assets. What stood out were investments in banking, finance and tourism.

CEFC's engagements in the tourism sector are important because China suggested that it desires to transform the Czech Republic into a hub, which will be able to attract a greater number of Chinese tourists. There

are currently four existing direct flights from the Czech Republic to cities in China, namely Beijing, Shanghai, Chengdu and Sian. In this regard, it has been repeatedly announced that the country was to become a „gateway“ for Chinese diaspora, which will be accompanied by Chinese businesses. According to the Czech Statistical Office, in the last three years the number of Chinese tourists has almost tripled from 285 thousands in 2015 to 620 thousands in 2018.<sup>178</sup> The goal of transforming the Czech Republic into a „gateway“ can partially be made easier following acquisitions in air transport. After taking over CEFC's assets CITIC holds a 50% ownership stake in Czech airline Travel Service, which owns a majority stake in the national Czech airlines company CSA. In addition, there has been an acquisition in tourism industry as CEFC and later on CITIC entered the travel agency Invia.cz. Given these activities, CEFC's new owner CITIC Group is likely to follow up on this tradition of being active in the tourism industry.

Expansion in the financial sector fitted into CEFC's strategy as well. It knew that greater involvement with J&T Finance Group would enable broader access to European markets, and that the company would benefit significantly from cooperation with an EU-licensed bank. In October 2014, during the visit of President Zeman to China, CEFC thus signed a treaty on strategic cooperation with J&T Finance Group, which eventually resulted in its acquisition of a 9.9% stake. CEFC expressed a desire to increase this share to almost 50%. But at the end of 2017, a long-awaited agreement fell through. Its 50% share was declined by the Czech National Bank due to doubts about the origin of its finances.<sup>179</sup> These challenges affected its upcoming activities, including its planned takeover of the Central European Media Enterprise group (CME), which owns one of the major Czech TV stations, Nova, among other assets. Despite this development, CITIC will keep its 9.9% share in J&T Finance Group.

CEFC's acquisitions, aside from the stake in J&T Finance Group, included:

- Real estate: the Florentinum office complex in Prague's downtown, two five-star hotels (the Mandarin Oriental and the Le Palais Art Hotel), the former Živnobanka building
- Brewing industry: Lobkowicz brewery (among the top 5 largest breweries in the Czech Republic)
- Engineering industry: machinery company ŽĐAS (along with its subsidiaries ŽĐAS SGS in Germany and TS Plzeň)
- Tourism sector: majority stake in the online travel agency Invia.cz (also operates in Slovakia, Poland and Hungary), 49.94% in the Czech Republic's biggest private airline Travel Service
- Media: 30% in the Médea Group and 49% in Empresa Media, which is in control of Barrandov TV station (CEFC sold its share in 2017)

<sup>176</sup> „Antimonopolní úřad posvětil vstup CITIC Group do CEFC Europe“; idnes.cz; 22.06.2018 ([https://www.idnes.cz/ekonomika/domaci/uohs-citic-group-cefc-europe.A180622\\_163344\\_ekonomika\\_hm1](https://www.idnes.cz/ekonomika/domaci/uohs-citic-group-cefc-europe.A180622_163344_ekonomika_hm1))

<sup>177</sup> „Pohledávky splaceny. J&T dostala od CITIC Group 11,5 miliardy, které jí dlužila CEFC“; Euro; 25.05.2018 (available at <https://www.euro.cz/byznys/j-t-se-dohodla-s-cinskou-citic-group-na-prodeji-pohledavek-cefc-1407160>)

<sup>178</sup> Prokeš, Jan; „Čínských turistů v Česku výrazně přibývá“; *Hospodářské noviny*; 8.2.2019 (available at <https://archiv.ihned.cz/c1-66469160-cinskych-turistu-v-cesku-vyrazne-pribyva>)

<sup>179</sup> Zlámalová, Lenka; „Centrální banka odmítá povolit vstup Zemanových Číňanů do banky J&T“; Echo24.cz; 03.01.2018 (available at <https://www.echo24.cz/a/S3Fbt/centralni-banka-odmita-povolit-vstup-zemanovych-cinanu-do-banky-jt>)

CEFC's shopping spree continued in 2017 with its takeover of the Slavia Praha football club, the national league champion in 2017, together with its stadium. In November 2018, Chinese company Sinobo Group – real estate development company – became the new majority shareholder of Slavia Prague, while CITIC Group remained a minority shareholder. In addition, the stadium in Eden was named „Sinobo Stadium” after the new owner.<sup>180</sup>

While it may be difficult to predict CITIC Group's investment strategy given its complex interests as one of the largest Chinese state-owned entities, it is highly likely that the group will remain active in the Czech Republic. Maintaining a strategic presence, together with working towards a high level of political relations, can be viewed as goals from which the firm is not likely to deviate. In early 2019, CITIC Europe increased its capital basis to a complete takeover of CEFC's assets, which was finalized in the first quarter of 2019.

As regards new plans, CITIC Europe allegedly shows significant interest in purchasing a smaller airport in Vodochody near Prague from the Czechoslovak investment group Penta, which would fit into the strategy of being active in the tourism sector.<sup>181</sup> Other new projects are planned across several priority areas, including the financial sector, aviation and tourism, food processing, agriculture and industry, according to Tvrdík, member of the supervisory board of CITIC Europe (the country's former minister of defense and member of Social Democratic Party).<sup>182</sup>

But in light of CITIC Group's worldwide operations, it is probable that the Czech Republic will not be a “gateway” for Chinese business in Europe. In the initial phase, CITIC will rather be keen to ease tensions linked to the debt problems of CEFC and the arrest of its founder, which substantially contributed to the negative public image of Chinese investments in the Czech Republic. Moreover, restructuring may involve selling off assets that are found to be of little value, or if CITIC Group finds it more within their overall investment framework to find other investors. This occurred, for example, with the Slavia football club. It is fair to assume that, as a state-owned enterprise, CITIC's general policy will be better aligned with Beijing's priorities, focusing on investments that fit into the Belt and Road Initiative.

## OTHER NOTEWORTHY INVESTMENT PROJECTS

Given the increasing scrutiny faced by Chinese telecommunications firm Huawei over its ties to the Chinese government, it is worth noting that the

Czech cyber watchdog (National Cyber and Information Security Agency - NÚKIB) published a warning on December 17, 2018 against the use of both hardware and software produced by the Chinese telecommunications entities Huawei and ZTE. It emphasized that the “main issue is the legal and political environment of People's Republic of China [...] China's laws, among other things, require private companies residing in China to cooperate with intelligence services, therefore introducing them into the key state systems might present a threat,” said Agency Director Dusan Navratil. Under the law on cybersecurity (effective since 2015), a NÚKIB warning does not constitute an outright ban but requires some 160 public and private operators of critical infrastructure, which are essential to the functioning of the state (including power plants, telecommunications companies, and waterworks) to conduct an analysis of risks and take “appropriate action”.<sup>183</sup> The Ministry of Health has already suggested that they won't allow either Huawei or ZTE products within its IT infrastructure.<sup>184</sup>

These allegations have been denied by the Czech branch of Huawei, which has demanded that evidence be presented in support of these claims. The warning does not affect consumer products, such as mobile phones, but it indirectly seeks to severely restrict the role Huawei can play in 5G network development, and to block it from supplying equipment to public and private entities deemed critical to national security.

Concerning other projects, there had been strong interest from CRRC, one of the China's largest rolling stock manufacturers, in Skoda Transportation, the largest CEE train and locomotive producer, and Railway Research Institute, a subsidiary of the Czech national railway company, which assesses rail transport. It should be noted that Skoda Transportation is a license holder for the EU common market, which carries significant added value when it comes to the purchase.<sup>185</sup> More importantly, within the Belt and Road Initiative China aims to build a global network of railways, and this acquisition would have made it easier to increase CRRC's position on the European market. Despite this interest, in late 2017 Skoda Transportation was sold to Czech businessman Petr Kellner, whose business portfolio is largely focused on the Chinese market.

Czech private train and bus operator Leo Express has also been in discussion with CRRC since December 2016 over the purchase of three trains, which are planned to be supplied in the second half of 2019 (with the possibility of acquiring another 30). After these trains are certified, Leo Express plans to use them in the Czech Republic, Poland and Slovakia, which would mean a great success for CRRC in positioning itself on the Central European market.<sup>186</sup>

180 “Sinobo Group is the new majority shareholder of Slavia”; *Slavia*; 20.11.2018 (available at <https://en.slavia.cz/clanek.asp?id=Sinobo-Group-is-the-new-majority-shareholder-of-Slavia-308>)

181 Slonková, Sabina; “Čínský CITIC má zájem o letiště ve Vodochodech”; *Neovlivni.cz*; 26.3.2019 (available at <https://neovlivni.cz/cinsky-citic-ma-zajem-o-letiste-ve-vodochodech/>)

182 Bukovský, Jaroslav; “Následník české CEFC v Česku nabral stamiliony”; *E15.cz*; 7.3.2019 (available at <https://www.e15.cz/domaci/naslednik-cinske-cefc-v-cesku-nabral-stamiliony-1356931>)

183 “Software and hardware of Huawei and ZTE is a security threat”; *National Cyber Security Center*; (available at <https://www.govcert.cz/en/info/events/2682-software-and-hardware-of-huawei-and-zte-is-a-security-threat/>)

184 “S Huawei končí první ministerstva”; *Novinky.cz*; 8.2.2019 (available at <https://www.novinky.cz/internet-a-pc/496752-s-huawei-konci-prvni-ministerstva.html>)

185 “Peking chce propojit zeměkouli kolejemi. Lokomotivy má dodat Škoda Transportation, ale obchod vážně”; *Hlídací pes*; 31.8.2017 (available <https://hlidacipes.org/peking-chce-propojit-zemekouli-kolejemi-lokomotivy-ma-dodat-skoda-transportation-obchod-vazne/>)

186 “Leo Express doveze první vlaky z Číny v druhé polovině roku”; *e15.cz*; 27.4.2019 (available at <https://www.e15.cz/byznys/doprava-a-logistika/leo-express-doveze-prvni-vlaky-z-ciny-v-druhe-polovine-roku-1358394>)

In the nuclear industry, state-owned China General Nuclear Company (CGN) has been highlighted as one of the six companies that expressed interest in the expansion of the Czech nuclear power plants at Dukovany and Temelín. Other players include American Westinghouse, Russian Rosatom, South Korean Hydro and Nuclear Power, French EDF and the Franco-Japanese AREVA-Mitsubishi Heavy Industries joint venture Atmea.<sup>187</sup> Three years ago, the British government paused approval for the 25 million USD Hinkley Point C nuclear project in England because of security concerns over CGN's stake. More recently, the US assistant secretary for international security and non-proliferation, Christopher Ashley Ford, suggested that CGN is engaged in taking civilian nuclear technology and repurposing it for military uses.<sup>188</sup>

Although the Czech government's 2015 energy policy designates nuclear power to become the main source of electricity production, actual talks on its expansion have been making slow progress due to disagreements on the investor model and identifying appropriate way for financing construction.<sup>189</sup> But CGN's participation in the expansion of the Czech nuclear power plant would represent a major boost to Chinese FDI

presence in the country, yet potential security concerns are likely to play an important factor in finding the right investor.

There are also other companies that have decided to enter the Czech market and have invested with some degree of success. The Changhong LCD TV factory near Nymburk can be considered one of those investments that were made from the ground up, and since 2016 roughly 40 million USD were invested in this facility.<sup>190</sup> On the other hand, Shanghai Maling's effort to develop a canned meat production facility in the region of Ústí nad Labem bore little fruit as the Chinese investor filed for bankruptcy in 2016. In another example, in 2016 Hong Kong-based investment company Eurasia Development Group purchased a network of Mountfield home supply stores in Slovakia and the Czech Republic.

In late 2017 it was suggested that the Chinese group Linglong, the country's third largest tire maker, would choose the Czech region of Moravia-Silesia to host its European tyre factory. The company said it had also studied a number of other sites in Poland, Slovakia and Hungary, but the investor finally decide to settle at a site in northern Serbia due to its "low labor and energy costs".<sup>191</sup>

## 4. INVESTMENT SCREENING MECHANISM

In an increasingly interconnected and interdependent world, the national security dimensions of economic and financial relations have received relatively little attention in the post-Cold war period. Rules-based market competition was perceived as an area that can hardly be exploited to gain undue leverage and ultimately achieve foreign policy objectives.

In the EU and other NATO allied countries, this perception has changed in 2016 with the purchase of German robotics maker Kuka by Chinese company Midea, which raised concerns that China was gaining too much access to key technologies. Some EU member countries, namely France, Germany, and Italy, began to worry about a possible sell-out of European expertise because there were no effective instruments in place to prevent this practice from recurring.

In response to the EU framework for screening FDI, which acknowledges that greater scrutiny is required over purchases by foreign companies that target the EU's strategic assets, in June 2018 the National Security

Council in the Czech Republic created a working group composed of selected government officials from a wide range of ministries and other government bodies, whose task is to evaluate possible scenarios of the Czech Republic's approach towards FDI with greater emphasis on security concerns. Thus far, the inter-ministerial working group has met four times.<sup>192</sup>

From these meetings and other reports it is possible to comprehend the broad outline of the emerging investment screening mechanism. Due to different sensitivities among the sectors affected, it was agreed that a national screening mechanism will be based upon two regulatory regimes (investment screening in neighbouring Germany serves as a reference model for members of the working group):

1. Mandatory approvals will be required for a narrow list of FDI areas, which are critical to Czech national security (e.g. critical infrastructure, defence industry), and

187 Břeštan, Robert; "Zájem o Dukovany a Temelín. Američané přesouvají do Prahy svůj regionální úřad pro energetiku"; *Hlídací pes*; 9.8.2018 (available at <https://hlidacipes.org/zajem-o-dukovany-a-temelin-americane-presouvaji-do-prahy-svuj-regionalni-urad-pro-energetiku/>)

188 "US warns Britain against Chinese alliances on nuclear plants"; *Financial Times*; 24.10.2018 (available at <https://www.ft.com/content/84ab26f6-d7a5-11e8-a854-33d6f82e62f8>)

189 Harper, Jo; "Czech Republic weighs nuclear options"; *Deutsche welle*; 17.04.2018 (available at <https://www.dw.com/en/czech-republic-weighs-nuclear-options/a-43419787>)

190 "Čínská Changhong otevřela v Nymburku po montovně i vývojové centrum"; e15; 1.06.2016 (available at <https://www.e15.cz/magazin/cinska-changhong-otevrela-v-nymburku-po-montovne-i-vyvojove-centrum-1292073>)

191 Pourriahi, Shahrzad; "Linglong tire plant to be built in Serbia"; *Rubber&Plastic News*; 21.8.2018 (available at <https://www.rubbernews.com/article/20180821/NEWS/180829986/linglong-tire-plant-to-be-built-in-serbia>)

192 "Prověřování zahraničních investic"; Ministerstvo průmyslu a obchodu; (available at <https://www.mpo.cz/cz/zahranicni-obchod/proverovani-zahranicnich-investic/>)

2. Potential screening of other investments deemed risky may be allowed, especially in designated priority areas (e.g. artificial intelligence, nanotechnology, robotics). In this regime investment screening would be possible for up to 5 years once the transaction is concluded. In order to receive “legal certainty”, the investor may voluntarily ask for investment screening.

Selected experts from various government agencies have until now also weighed in on possibilities for cooperation among their agencies or the timetable needed to conduct a thorough investment screening.

Simultaneously, the Ministry of Industry and Trade has begun to prepare a legislative framework, which will serve as a basis for the creation of a Czech investment screening mechanism. Once concluded, it will be presented to members of the inter-ministerial working group for comment.

If a certain transaction does raise security concerns and no mitigation measures are found as part of the investment screening process, a final decision would be taken by the government (based on experiences from other EU member states). Based on estimates from the Ministry of Industry and Trade, it is assumed that up to 300 transactions would potentially be screened every year. However, less than 10 of them would

undergo a thorough investment screening investigation. Thus, the vast majority of screened transactions usually do not raise any red flags.<sup>193</sup>

In order to introduce possible examples of cases which may be screened if the mechanism had been introduced earlier, the case of a nanotechnology company, HE3DA Technologies, is instructive. The company invented a new type of lithium battery and decided to partner with an entity registered in Germany, which was owned by Chinese investor CDG.<sup>194</sup> It was lured into doing so by a generous financing package. Consequently, it was discovered that the Chinese-owned entity attempted to engage in technology theft, clearly signaling to Czech officials that more work needed to be done to secure the country’s technological know-how.

While the government had no effective tools at the time to conduct effective investment screening, companies may also be uncertain of how to best proceed, for example, in approaching opportunities for minority and early stage-investments that could be later exploited to acquire critical technologies. Having one of the most open investment frameworks in the EU and a highly industrialized economy that places great emphasis on critical technologies, the Czech Republic may easily emerge as a target of foreign investments focused on strategic niches of the economy. This is especially the case in the field of artificial intelligence, where the Czech government is actively lobbying to become a Center of Excellence for AI, a matter which should be decided by the end of 2019.

## 5. CONCLUSION

China is an important source of imports for the Czech Republic, and also a potentially important market for its exports. However, it should be clear from the preceding analysis that China is just one of many among the Czech Republic’s economic partners, and accounts for a relatively small minority of its trade and investment. As such, with comparison to other Asian trading partners like South Korea or Taiwan, China’s role in the Czech economy remains marginal. What is more, ambitious agreements by the two countries’ leaders have failed to stimulate existing economic ties, suggesting that even with government support China’s role will remain limited, and government support cannot be taken for granted. In addition, the emerging Czech and European Union investment screening mechanisms will not target Chinese firms exclusively, but are likely to bring a considerable amount of Chinese activity in the country under increased governmental scrutiny.

In all conceivable futures, the Czech Republic will never rival China in international influence or economic power. As such, their relations will

always be asymmetrical. For instance, the Czech Republic could benefit substantially from even a small increase in its share of exports, while in the reverse case the impact on the Chinese economy would be negligible. For China, the Czech Republic is bound to remain instrumental— a source of relatively cheap assets allowing for privileged access to EU markets, a base of operations for its firms’ European headquarters, a convenient logistical hub in the heart of the EU.

<sup>193</sup> “Stát připravuje mechanismus prověřování zahraničních investic”; *Finance.cz*; 26.2.2019 (available at <https://www.finance.cz/520401-stat-pripravuje-mechanismus-proverovani-zahranicnich-investic/>)

<sup>194</sup> Břešťan, Robert; “Číňané se po půl roce ozvali: v české firmě HE3DA jsme špionáž nedělali”; *Hlídací pes*; 25.05.2018 (available at <https://hlidacipes.org/cinane-se-po-pul-roce-ozvali-v-ceske-firme-he3da-jsme-spionaz-nedelali/>)



## CONCLUSION

The various contributions to this volume establish that, at least superficially, the character of each of the Visegrad countries + Serbia countries' economic relations with China are fairly similar. Each recognizes China as a potentially important partner due to the size of its economy and expanding FDI portfolio, but faces security concerns about granting a foreign power too much influence in its domestic affairs and skepticism about China's long-term intentions. In addition, none of these countries are willing to alienate their European partners in pursuing deeper relations with China, as the other EU countries in general and Germany in particular remain primary economic partners for all of them. Each country is forced to strike a balance between creating favorable conditions for China to drive economic growth and preserving an independent voice in negotiations and overall national security.

It is in their particular approach to this balance that most of the variation in these countries' relations with China is found. To summarize this volume's findings, Hungary was the first in the region to sign on to the Belt and Road Initiative and since then has taken a relatively welcoming approach to Chinese activity in the country. Poland expressed initial interest in working with China, but has been disappointed by the persistence of limits on its access to the Chinese market and lower-than-expected investment levels. Serbia looks set to play a critical role in the BRI infrastructure and has high hopes for its partnership with China. Slovakia's relationship with China remains limited and characterized by concerns about Chinese respect for Slovak sovereignty and security. And finally, the Czech Republic's politicians showed strong interest in a greater role for China in the country's economy, but for a variety of reasons it has so far mostly failed to materialize.

It would be a great oversimplification to say that the variation in these countries' approaches to relations with China could be explained by a single variable. But it is worth noting that there does seem to be a strong negative correlation between recent national GDP growth and the extent to which strong economic ties between these countries and China have

materialized. According to the World Bank, between 2010 and 2017 Hungary averaged GDP growth of 2.1%, while in Serbia growth over the same period averaged just under 1%. Compare this with Poland (3.5%) and Slovakia (3.1%), and it seems that a country's willingness to agree to the terms on which China wants to do business may largely be a function of the health of its underlying economy. In other words, countries with relatively weak prospects for growth may be those most willing to yield to Chinese terms. The Czech Republic grew 2.2% per year over this period, but with the highest level of GDP per capita in the region it may also be considered a relatively strong economy.

While it may seem obvious that those countries lacking other prospects for growth would be those most interested in opening up to Chinese interests, this nonetheless has important implications for our understanding of China's role in the region. Overall, it suggests China's influence may remain concentrated in Europe's more peripheral economies, rather than the more robust markets in which China holds the strongest long-term interest. But perhaps more importantly, it suggests that, given a fairly high degree of economic security, the countries of Central Europe and possibly elsewhere may prefer not to have much to do with China after all in order to preserve their national autonomy and security. Judging by the case-studies in this volume, investment from China on Chinese terms appears to be more of a last resort than a truly appealing prospect. Ultimately, this illustrates the importance of continuing Central and Eastern Europe's integration with the Western European economic core of the EU, a process that may be aided by the emergence of a cooperative framework for investment screening mechanisms. And finally, it shows us that there is nothing "set in stone" about the form the BRI project will take in this region; the grand transnational logic of reviving the ancient "Silk Road" will inevitably have to be reconciled with the present-day reality of a world of legally equal sovereign states representing their own diverse interests.



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