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CHINESE INVESTMENT IN CENTRAL AND EASTERN EUROPEAN COUNTRIES: THE ANALYSIS OF EU FACTOR

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Chinese investment in Central and Eastern European Countries: the analysis of EU factor[1]

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Chinese investment in Central and Eastern European Countries[2]: the analysis of EU factor[3]

Zhang Fumei[4]

1. Introduction

Historically, the international relationship between China and the European Union mainly refers to trade and investment with western European countries. However, the cooperation between China and CEE countries is much neglected under the EU framework. After profound international political economic change followed by European crisis and China's rise, these two parties started to seek for cooperation under the "16+1" formula in 2012. Recent years have seen a big growth in trade and investment between China and CEE countries under the cooperation scheme. However, as the deepest integration actor in the world so far, the Central and Eastern European member states still show great economic dependence on western EU members, and member states are still facing EU institutional constraints when dealing with third countries. Therefore there are many uncertainties and challenges for this bilateral China-CEE cooperation.

[2] CEE countries refer to 16 countries with 11 EU member states Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania Slovakia, and Slovenia and five non-EU countries: Serbia**,** Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro.

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In this study, I am going to focus on CEE countries only with EU membership. The first part examines how the scholars or politicians see Chinese presence in CEE countries from both western and Chinese sides. However, it is also important to clarify that there are even different opinions from western EU and CEE countries. In the second part, some data will be provided to show the trend of Chinese investment in CEE countries in recent years. Based on the literature review and data analysis, I mainly discuss EU constraints from three points of view: economic constraints which refer to the great dependence of CEE countries on western European countries regarding to trade, foreign investment and structural fund, political constraints such as the negative responses toward Chinese FDI from western EU countries due to national securities, environment and labor standards etc., and institutional constraints focusing on EU investment policies and other EU institutional rules.

2. Literature review

There are quite a few research papers on the motivation behind China's presence in the CEE region and what "The New Silk Road" and "16+1" will bring to the EU integration. The internal and external motivations for China to seek for cooperation with CEE countries will be summarized based on the literature review both from Chinese scholars and western ones.

From western sides, except for economic motivation, political motivation such as "divide and rule" EU, "China's Threat" are quite popular and they believe this project reveals great geopolitical interests for China.

China's trade and investment are traditionally concentrated in the western EU countries such as UK, France and Germany but these countries present higher requirement concerning investment law, issues of human rights, transparency and securities (Sophie, 2014). Meanwhile CEE countries can be a perfect entrance into the western market with relatively cheap labor, rich resources and favorable institutional environments.

Some experts think that the competition among CEE countries for Chinese money will actually pose a threat for EU integration and Brussels will find it more difficult to achieve a common ground vis-à-vis Beijing based on the fact that member states pursue their own national interests toward Chinese FDI (Casarini, 2015). Besides, it concerns Brussels that the establishment of a Permanent Secretariat at the Chinese Foreign Ministry[5]and the annual summit participated by leaders of all countries will inevitably form certain “pro-China lobby” groups in the EU. The increasing power of China in this region will enable China to influence the national choice of member states, thus leaving EU’s common China policy hard to reach (Van der Putten, 2016).

The voice from government officials also reveals the intense criticism from western EU countries. Sigmar Gabriel, the German vice-chancellor and foreign minister, called on Beijing to respect the concept of “one Europe” adding: *“If we do not succeed for example in developing a single strategy towards China, then China will succeed in dividing Europe*.”(Yuriy, 2017). However, some other scholars insist that China is still far away from leading CEE countries to “divide” EU due to its newcomer position in this region but it is not clear yet about whether China’s long-term goal is to be strong enough to serve as a “dividing” force. Instead, EU internal problems have already threatened further EU integration. It seems, at present, a weak and divided EU is not what China wants to see, but it doesn’t mean China won’t play this card for the sake of its own national interests if it had capacity (Turcsányi, 2014).

European diplomats also believed that the Chinese government needs international support for the hot territorial issues such as the dispute on South China Sea, Taiwan and Tibet. It has already been shown when EU 28 member states discussed their position in the international court about China’s violation of international law to claim the South China Sea. Hungary and Greece refused to criticize China, and some other countries facing the maritime issues also didn’t express a strong stand on the South China Sea issue (Robin. 2016).

By contrast, from the Chinese sides, the remarks are more popular that China’s economic motivations such as production overcapacity, mutual economic interests and

[5] The established Secretariat shows the institutionalization of “16+1” formula and is responsible for coordinating various institutions including the Ministry of Foreign Affairs, the International Department of the Central Committee of the Communist Party of China, the National Development and Reform Commission, and the ministries of Finance, Commerce, Transport, Agriculture, Education, Culture and others. The other mission for the Secretariat is to maintain regular contact with partners from the CEE-16.

financial support, and they object to the geopolitical goal mentioned by western scholars. China's official paper tried to mitigate the suspicion from western world by stressing the "16+1" formula or "The New Silk Road" are cooperation among participants that suits the mutual benefits. China's experts try to emphasize that these two initiatives reflect China's economic goals rather than geopolitical motivation. The frequent meetings among leaders of China and CEE countries tried to show the Chinese genuine motivation in order to improve China's international image and to offset negative response from foreign media. China's premier, Li Keqiang points out that "16+1" cooperation is not a geopolitical tool, but rather an "incubator" of practical, trans-regional cooperation aiming at promoting a balanced development of relations between China and the EU (Yuriy, 2017). China's expert, Liu (2015) emphasizes the great economic opportunities of Chinese investment for CEE countries after the trauma of debt crisis. China's investment in CEE countries reflects a short term "window opportunity" rather than long term strategic goal. Chinese investors should seize the opportunity which could help China to upgrade its economic structure in global value chains and have access to the technology and skills penetrated through western investment in this region.

Typically, I find that most research about this topic conducted by Chinese scholars are concentrated more on economic perspective as well as challenges and risks China will face during their investments.

From the literature review above, I found that scholars focus more on the motivation behind the"16+1"platform and the implication of the China-CEE bilateral cooperation on the EU. However, another issue that is overlooked is that China's entry in CEE countries has to face great challenges and obstacles when no consensus is reached on the EU level. And there is a research gap about how the EU institutional framework will influence the national choice of member states in building up foreign relations with China. China's effort to build close ties with CEE countries will cause disagreements among core and periphery countries since China's investment projects sometimes violate EU investment law. For example, the project of railway to be built between Budapest and Belgrade is currently under investigation because Brussels suspects it may violate EU bidding law (James &Micheal, 2017). Jin Ling (2015) mentions in the article "*EU factor analysis in* *external economic cooperation between CEE with third countries*" that due to the market and capital overdependence on EU, EU institutional constraints and ideological recognition, national choice of these small countries will be influenced by EU framework in terms of their bilateral relation with third countries. Liu (2015) also mentions that China's investment in CEE countries has to deal with the pressure from EU core countries because they are quite suspicious about the institutionalized cooperation built between China and CEE countries. Ma (2015) recommends that the Chinese government should consider the diverse concerns from the core EU countries, especially German and France since these two countries have ever seen the CEE region as a strategically important position. And it is necessary for China to properly handle the relationship with the key stakeholders in the region.

3. The recent trend of Chinese OFDI in CEE countries

Recent years have seen an increase of Chinese FDI in the CEE region. It is worth noting that there can be huge discrepancies among different data sources. The data of Chinese OFDI in the CEE region are taken from MOFCOM publication*:2016 Statistical Bulletin of China's Outward Foreign Direct* with the data available from 2008 to 2016. **See Table 1.** According to Chinese statistics, most of CEE countries have received more Chinese FDI since the euro crisis, especially in V4 countries: Hungary, Czech Republic, Poland and Slovakia, which take up 66.7% of total Chinese FDI in CEE countries and have seen a great growth since 2008.Until 2015, Chinese OFDI in V4 countries has increased by more than 65%, with total value from 769 million dollars to 1280 million dollars (Chen, 2017). However, compared with the OFDI in 2015, Chinese investment stock decreased in Hungary, Bulgaria and Slovakia in 2016, and it was indicated that Chinese OFDI stock in the end of 2016 includes the adjusted historical statistics in these three countries.

It is obvious that these countries present positive economic environment, institutional stability, total market size and they are integrated deeply in the supply chains of EU market which make them more attractive from Chinese investors (Ágnes Szunomár, 2014). Nevertheless, Romania, Bulgaria, and non-EU countries such as Serbia and other Balkan countries are also important FDI host countries due to the strategic geopolitical position, though non-EU countries are not shown on the lists since I mainly focus on the EU member states. The data can be underestimated because the investments from Chinese small and medium enterprises are not included in the data and the data collection is usually delayed for one year.

Chinese investment fields involve infrastructure construction, energy sectors, tourism and housing estate etc… Compared with western EU counties, a large share of China companies invests in manufacturing sector, construction sectors and telecommunication networks but fewer conducted R&D activities in CEE countries. Therefore, Chinese investors tend to focus on market size and high technologies in western EU countries, while they are attracted by the cheap labor and relatively low institutional barriers such as lower standards for entry and less transparency (Kirsten Fasshauer, 2012).

Table 1. The total stock of Chinese OFDI in CEE countries with EU membership from 2008 to 2016 (million dollars)

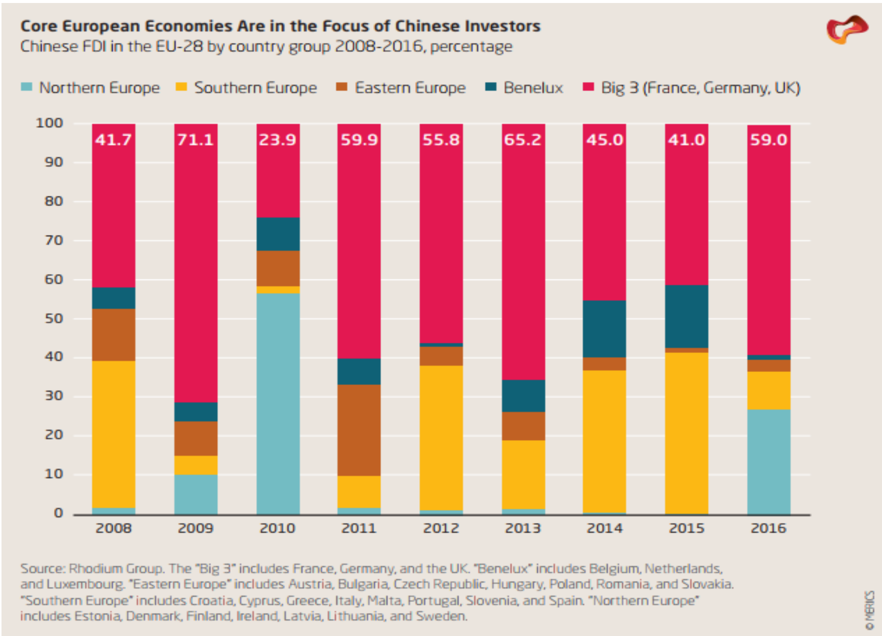
Countries	2008	2009	2010	2011	2012	2013	2014	2015	2016
Poland	109.9	120.3	140.3	201.3	208.1	257	329.4	352.1	321.3
Czech	32.43	49.34	52.33	66.83	202.5	204.7	242.7	224.3	227.8
Hungary	88.75	97.41	465.7	475.4	507.4	532.4	556.4	571.1	313.7
Slovakia	5.1	9.36	9.82	25.78	86	82.8	127.8	127.8	82.77
Bulgaria	4.74	2.31	18.6	72.56	126.7	149.9	170.3	236	166.1
Romania	85.66	93.34	125	125.8	161.1	145.1	191.3	364.8	391.5
Croatia	7.84	8.1	8.13	8.18	8.63	8.31	11.87	11.82	11.99
Slovenia	1.4	5	5	5	5	5	5	5	26.86
Latvia	0.57	0.54	0.54	0.54	0.54	0.54	0.54	0.94	0.94
Lithuania	3.93	3.93	3.93	3.93	6.97	12.48	12.48	12.48	15.29
Estonia	1.26	7.5	7.5	7.5	3.5	3.5	3.5	3.5	3.5

Source of data: MOFCOM: NBS, MOFCOM and SAFE: *2016 Statistical Bulletin of China's Outward Foreign Direct available at:*http://images.mofcom.gov.cn/fec/201711/20171114083528539.pdf. table created by author.

Despite the fact that the value of Chinese OFDI shows an increasing trend in CEE regions, its share of Chinese total OFDI in the EU or Europe is still marginalized. Therefore, China's strategic target remains to be the western EU market. The graph below shows how the dynamics of Chinese FDI is developing in the regional distribution. **See Graph 2.**

The big three including France, Germany and UK are the main recipients, and developed EU countries always take more than half of the FDI. Since the debt crisis, Chinese started to take the opportunity to buy out the bankrupt companies. Therefore, there is great growth in Southern European countries after 2011. Eastern European countries only take up a quite small share of total Chinese FDI. It is still not evident to claim that there is a dramatic change of Chinese investment in the CEE region with political motivation. Instead, developed EU countries, especially core EU countries receive great attention from Chinese investors for technology transfer and huge market size.

Graph 2. Core European economies are in the focus of Chinese investors[6]



[6] *Source of graph:* Meric and Rodium Group, (2017): *Chinese Investment in Europe: Record Flows and Growing Imbalance, available at* https://www.merics.org/en/papers-on-china/chinese-investment-europe-record-flows-and-growing-imbalances

4. EU constraints for Chinese investment in CEE countries

CEE countries aim to improve their development through diversification of foreign relations instead of unilaterally relying on the core EU countries. However, since some of the CEE countries joined EU, the core countries have required them to achieve some criteria at EU level such as inflation rate, fiscal deficit and debt ration based on the Maastricht Treaty. Besides, both economic asymmetric interdependence on core countries and the EU institutional rules and regulations more or less restrain the national foreign policy choices of those CEE member states. Therefore, bilateral cooperation in different fields between China and CEE countries is facing a lot of uncertainties and challenges under the EU institutions. I have analyzed these constraints from three perspectives: economic constraints, political opposition, and institutional constraints at EU level.

4.1 Economic constraints

The domestic economy of CEE countries heavily relies on the western EU in terms of investment volume, trade and financial sources. The data in the table below shows that the all Visegrad Group (V4) members including Hungary, Slovakia, Czech Republic, Poland export around 80% of the total to the EU market. Other CEE countries also show great dependence on the single market with export proportion of 60% -70%.

Besides, the EU market is also the main origin for the imports of these countries, especially for Hungary, Latvia, Romania and Croatia with a great import share of almost 80%. By contrast, trade volume between China and CEE countries is far lagging behind, though it has been improved in recent years. **See Table 3.** In fact, the CEE countries are closely integrated into the common EU market and have formed a vertical production integration with western EU countries in European value chain. Meanwhile, they are also much more likely to be affected by an economic crisis in any other EU member states due to the strong dependence.

Table 3. The comparison of merchandise trade between CEE countries and other EU vs China (2016)

Trade partners	Export to EU	Import from EU	Export to China	Import from China
Poland	78.9%	59.6%	---[7]	12.4%
Czech	83.7%	67.3%	---	12.7%
Hungary	79.4%	78%	2.2%	5.3%
Slovakia	85.1%	58.3%	1.6%	8.4%
Bulgaria	66.8%	66.1%	1.8%	4%
Romania	75%	77.1%	---	5.1%
Croatia	66.3%	77.2%	---	3%
Slovenia	76.6%	70.8%	---	6.5%
Latvia	73.8%	79.8%	---	3.3%
Lithuania	60.7%	70.5%	---	2.9%
Estonia	69.2%	66.7%	---	8%

Source of data: http://stat.wto.org/CountryProfile/WSDBCountryPFReporter.aspx?Language. Created by the author.

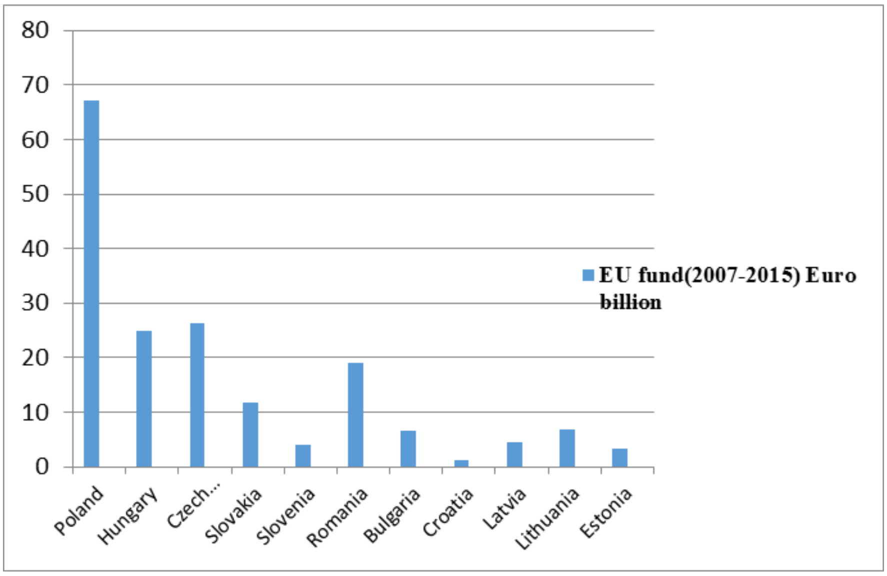
Besides, the main sources of FDI inflow into the CEE countries are from the EU which takes up 79% due to the regional integration, and since developed economies transferred the industrial manufacturing into the CEE region to lower their production costs (Jin, 2014). MNCs from core EU countries (mainly German MNCs) make CEE regions their raw material suppliers and production base, which The CEE countries export the intermediate or final products to the home countries and then re-export to China. In this sense, the trade volume doesn't actually imply the trade relations among China, CEE countries and western EU countries. Besides, the measure of trade volume in this table might not take the trade in value added (TiVA)[8] into consideration which

[7] "---" indicates the data is not available and the share is quite small which can be ignored.
[8] OECD: http://www.oecd.org/sti/ind/measuring-trade-in-value-added.htm

addresses the conventional international trade issues by dividing the inputs of final products from different countries.

Another important factor is the role of the EU structural fund in improving the development of new member states. EU allocates 80% structural fund to the regional areas where GDP is under 75% of EU average level for the infrastructure construction. V4 countries are the largest recipient countries, and especially Poland received around EUR 70 billion EU funds from 2007 to 2015. These 11 CEE countries altogether were allocated EUR 175.89 billion from EU structural and cohesion fund. **See Graph 4**

Graph 4. EU funds allocation in CEE countries (2007-2015)



Source of data: KPMG. *EU funds in Central and Eastern Europe*.Progress report 2007-2015 Available at: https://assets.kpmg.com/content/dam/kpmg/pdf/2016/06/EU-Funds-in Central-and-Eastern-Europe.pdf. Graph created by author.

The Chinese government has also established an investment fund with EUR 10 billion for CEE countries in order to finance infrastructure construction in this region[9]. However, both the USD 10 billion special credit line and investment funds are quite small scale with high interest rates, and it probably takes long time to be implemented. One diplomat from Eastern Europe claimed "We don't need the Chinese money when we have EU funds, but when we don't have the money, we need the Chinese. Our companies can't compete on the Chinese market of public procurement, so it doesn't matter to us if

[9] Reuters: https://www.reuters.com/article/us-china-eastern-europe-fund/china-launches-11-billion-fund-for-central-eastern-europe-idUSKBN13105N

China opens up this market" (Euractiv, 2011). Therefore, to some degree, the future attitudes of CEE countries are determined by economic funding from the EU and China to large extent which adds uncertainties in this bilateral cooperation.

Surprisingly, since the establishment of "16+1" platform, there hasn't been great change in FDI and trade in CEE countries. In fact, this government led cooperation doesn't work very well, although the "16+1" summit was held every year. Besides, as mentioned above, China has a large share of investment volume in western EU countries since their main target is to gain market and acquire technology acquisition. As Chinese economic interests are stronger in western EU countries than in CEE regions, core EU countries still have strong bargaining power in negotiation with Chinese counterpart.

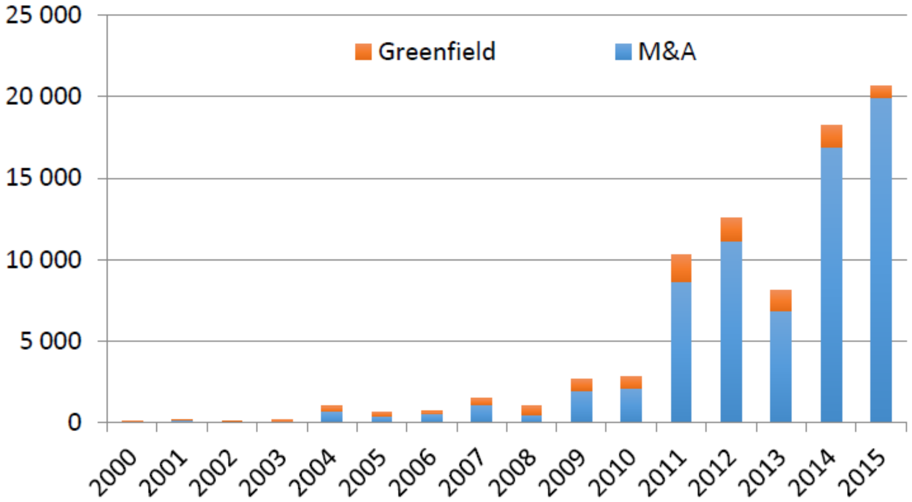
4.1 Political constraints

In recent years, Chinese merger & acquisition (M&A) activities in European countries are growing which provoked great concern in western EU countries due to the issues such as technology transfer and national security. It can be seen from the graph that there has been a significant growth in the value of Chinese M&A cases in the EU since 2010. **See Graph 5.** The Euro crisis left many enterprises in bankruptcy which provided an opportunity for Chinese investors to conduct great amount of M&A deals and the M&A value reached up to 20 billion dollars in 2015[10]. However, the value of green field investment (GI) activities stayed quite stable with a small share. Based on EU-China FDI Monitor dataset, the M&A value was even shockingly higher in 2016 with total value of nearly 35 billion euro, and it records a high accumulated Chinese FDI transaction value worth around 101 billion euro from 2000 to 2016[11].

This phenomenon led to a paradox position from western EU countries on Chinese investment. On one hand, they need and welcome Chinese money to save those bankrupt enterprises. On the other hand, they are actually cautious that the increasing M&A activities will result in technology transfer and hazard of national security. Those worries can be enhanced as Chinese investment grows in the CEE region since the possible consequences are not only generated at national level but also supranational level.

[10] Rhodium group, 2016.
[11] RHG EU-China FDI monitor

Graph 5. The value of Greenfield and M&A of Chinese OFDI in EU-28



Source of figure: taken from Jerker Hellström, (2016): Chinese Acquisition in Europe. European Perceptions of Chinese Investments and their Strategic Implications.

High percentage of investment volume from state-owned companies also makes them worried that the role of the government in the economies and the technologies could be used for both economic production and military weapons. For example, Chinese company" Fujian Grand Chip Investment Fund" attempted to acquire German company Aixtro in 2016 but it was refused by German policy maker due to the sensitivity of products "crystalline layers" which could be used in military production (Hanemann&Huotari,2017). Since there are also quite a lot investments from western EU countries in the CEE region, the core countries are inevitably vigilant in Chinese presence here. The EU commission called for a harmonized FDI scrutiny procedure[12] on FDI from a third country which sets up higher entry barriers for Chinese investors.

From perspective of CEE countries, it is their national choice to accept China's proposal for cooperation. There are possible economic and political motivations behind this choice. In economic terms, they need financial support to help them catch up with their western partners, and try to diversify their trade partners with a third of countries not highly relying on the EU. Besides, due to the internal problems, countries, especially Hungary, would like to win more bargaining power with Brussels and support their illiberal democratic process. The Polish Prime Minister responded towards the proposal

[12] European Commission, 2017, p. 20. Available at: https://ec.europa.eu/transparency/regdoc/rep/1/2017/EN/COM-2017-487-F1-EN-MAIN-PART-1.PDF

of tightening the scrutiny of Chinese OFDI that Poland is opposed to this protectionist measure in EU (Von der Burchard, 2017).

As is mentioned in literature review, negative political perceptions are quite popular that China's investment in the CEE region will "divide and rule" the EU by causing fierce competition and disagreements among member states. The core EU countries are cautious that Eurosceptic groups will unite and rise in CEE countries with the support from China. However, it is still a challenging for all CEE countries to unite as one if taking V4 as an example, and "16+1" formula remains to be the bilateral cooperation between China and the individual member state rather than the whole region. Actually, the existing internal discords from western EU countries and eastern countries in the EU inevitably put China into a disadvantageous situation where EU member states blame China for creating divergence inside the EU， despite the fact that China may not expect a dividing EU since it has attached more strategic importance on Western Europe regarding to both volume and sectoral distribution.

To sum it up, although Chinese FDI increased a lot in the EU, the political opposition from European countries about Chinese FDI, mainly from western EU countries imposes great pressure on Chinese companies which could pull back for future investment opportunities. The different attitudes of CEE governments from the core countries towards Chinese investment could make the situation even worse. The Chinese government doesn't want such a situation but may not be able to avoid it.

4.3 Institutional constraint

Although there is no common investment policy on supranational level, EU commission was delegated to negotiate BITs with third countries in order to protect EU's OFDI and regulate IFDI into member states under the Lisbon Treaty(Meunier, 2014a). Member states have established quite different BITs with China among each other due to their different standards on IFDI such as screening and scrutiny (European Commission, 2013). However, the IFDI projects from a third country can be supervised by EU institutions under competition policy and probably can be rejected due to non-transparency. And FDI has to be examined by EU institutions on member-state level when it comes to public security (Grieger, 2017).

For example, the Belgrade-Budapest railway, the pivot project under"16+1" platform was under EU investigation due to lack of transparency and violation of EU bidding laws and public procurement. The Serbian side of the railway is not affected by EU law but the part in Hungary is at probe by EU commission, which caused the delay of the project (Xinhua, 2017). And till now, the project is in suspension. A consensus is needed to achieve between Hungarian government and the EU counterparts to make sure the realization of the project.

Another failed case of Chinese investment project happened in 2009 when Chinese Overseas Engineer Group Co.(COVEC), a well-known construction company won the tender of building the motorway A2 with the lowest price. However, due to the shortage of finance and experience, the company had to abandon this project, and renegotiation about the price with Polish government was rejected[13]. Besides, another important reason is that this investment project failed to comply with the EU regulation such as labor standards and migration law etc.(Jin. 2015). In fact, most Chinese investors enter the EU market without having a good knowledge of rules and regulations of both host countries and EU institutions.

Last but not least, there are a lot of tools that EU can adopt to restrict Chinese FDI in Europe and the US has already taken measures to control Chinese national companies under the claim of national security, fair market access and technological transfers etc.. The negotiation of a BIT between China and the EU are undergoing. However there are a lot of requirements and standards which put the Chinese side in disadvantage when it comes to market access. The Chinese government will probably have to make a concession in order to achieve the treaties. China's lack of knowledge on EU regulations will also great obstacle for either the future BIT negotiations or current investment activities.

5. Conclusion

China's recent rising has attracted much attention from the international community. China started its global strategy with One Belt One Road Initiative (OBOR) which expands its global presence through huge infrastructure investment. "16+1"

[13] http://paper.people.com.cn/rmrbhwb/html/2011-06/17/content_848392.htm

platform is certainly an important part in the grand OBOR plan which links Asia with Europe. Since the EU is at the end of this plan and CEE countries are the entrance countries for China to enter the western EU market. The EU's internal problems such as regional inequality, migration, and euro crisis disappoint periphery countries in this economic and political convergence with their western partners. When China proposed this investment funding program, CEE countries gladly accepted this timely financial support.

To some degree, China's investment in Europe is quite opportunistic. Western EU countries are concerned about China's presence and its implication on EU integration. Therefore, bilateral cooperation between China and CEE countries lacks transparency and trust from EU level, and the institutionalized cooperation between these two parties will make it more difficult for EU member states to achieve common China policy. EU institution can restrain the national policy choices toward third countries from political, economic and institutional perspectives. Besides, asymmetric bargaining power between the west and east also makes it necessary for the Chinese government to take EU's concern and the core stakeholders into consideration in this bilateral cooperation. At present, China's presence in the CEE region is not so dramatic that could divide the EU and will be even limited in implementing some investment projects in CEE countries under the EU framework in the short run. The future negotiation of the ongoing bilateral investment treaty between the EU and China is quite important for the cooperation between China and CEE countries, but it will be an exhausting process.

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