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New Perspectives for Europe–China Relations

Throughout its history, the *Baltic Journal of European Studies* (*BJES*) has predominantly been focused on the themes and scenes related to Europe and the European Union (EU). The current Special Issue is looking far beyond, attempting to touch upon and, with a hope, to analyse a remarkable geo-strategic initiative of modern time, the Belt and Road Initiative (BRI), which is also known in academic and political discourse as One Belt, One Road (OBOR). Proposed by Chinese President Xi Jinping in 2013, the BRI is directly and indirectly linked with myriads of other China-originated handsels—for example, with the inward-oriented concept of Chinese Dream or, from a broader perspective, the Chinese state's bourgeoning cooperation with sixteen Central and Eastern European countries (16+1 Cooperation). All these developments, especially their truly impressive strategic amplitude, are something that Europe (in general) and the EU (in particular) have never experienced before. Declared by China as inclusive in its nature, the BRI and, for that matter, the 16+1 Cooperation are of great interest for scholars in different fields of academic research—from international relations to legal studies, from political economy to philosophy. Indeed, there is a high probability for a scholar to detect something intriguing within a framework, in which countries as different as Estonia and Croatia are engaged in cooperation with the world's most populous nation. Moreover, a high number of countries and organisations outside of the 16+1 'playground', namely the European Bank for Reconstruction and Development, Austria, Belarus, Switzerland, and some others, have also expressed their interest in participating at different stages.

This is all happening in a historic period of the highest complexity for interrelations on the global level. The Russia-sponsored Eurasian Economic Union (EEU) and its special emphasis on Central Asia, the EU sanctions on Russia because of its aggression against Ukraine, a range of mixed geo-strategic signals being sent to the international community by the Donald Trump Administration, the Brexit issue, and uncertainties related to North Korea—these are only a handful of big challenges which make the context of any analysis very different from what it would have been only a generation ago. At the same time, there is no better moment for a decent as well as constructively critical academic debate on the main features of the actuality. Given the fact that China is the second largest economic partner of the EU, the BRI is arguably one of those features.

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This Special Issue of *BJES* represents one of the first attempts by an EU-based academic peer-reviewed journal to provide a comprehensive platform for a critical academic discussion on the BRI. Responding to a call for papers jointly issued by *BJES* and Croatian International Relations Review (CIRR) back in September 2016, a solid group of high-profile international contributors from different academic fields, while employing rigorous methodology, decided to get engaged in a debate on the BRI, mechanisms of its implementation and results measurements, prospects for the initiative-bound business-related, academic and people-to-people cooperational linkages to be developed, the BRI's impact on the EU's interactions with China, and the Central, East and Southeast Europe's direct and indirect participation in the framework.

In the first paper, Dr. Yilmaz Kaplan from Erzurum Technical University is examining the OBOR initiative from the perspective of "geo-functional institutionalism". His argument is rather encouraging for Europeans: China is proposing not a hegemonic but rather a win-win concept of cooperation and has clearly functional and entrepreneurial capacity to implement the giant project. Furthermore, according to Kaplan, China's deliberativeness as a global actor provides a ground for parity and general consensus. At the same time, a tandem of Shanghai-based scholars, Dr. Lin Zhang and Dr. Zheqian Xu, express their concern that the institutional distance increases the costs, warning the policy makers that in order to strengthen cooperation within the BRI, the policy makers should "pay more attention to institutional differences among countries".

Dr. Andrea Éltető from Hungarian Academy of Sciences and Professor Dr. Katalin Antalóczy from Budapest Business School are screening the export strategies of the EU Member States, concluding that, although Europeans understand that "export is a motor of growth", there are certain pre-requisites for the successful export policies, such as transparency, stability and development of human capital. Dr. Duško Dimitrijević, professorial fellow at the Institute for International Politics and Economics in Belgrade, is contributing with a country-specific research on China–Serbia economic relations, focusing on Chinese investments. He explains the main reasons for the relations being "asymmetrical", suggesting that a change in methodology and economic policy applications is required for more successful cooperation between the two sides in the OBOR-bound framework.

A comparative analysis on Slovakia is presented by economist Dr. Liqun Zhang, a scholar of international relations Dr. Martin Grešš, and a practising lawyer Dr. Katarina Brocková. Their paper, which is based on solid empirical data, indicates that there is a chance that the so far insignificant Chinese-originated foreign direct investment inflow may turn to a positive trend and criticises the weakness of current legal framework on protecting Chinese investments in Slovakia.

Colleagues from Latvia, Professor Dr. Inna Šteinbuka, head of the EC Representation in Latvia and Member of Latvian Academy of Sciences, Professor Dr. Tatyana Muravska from the University of Latvia, and Andris Kužnieks, deputy head of the EC Representation in Latvia, are introducing a rather optimistic approach towards the EU–China as well as 16+1 cooperation. Moreover, the authors argue that "there are no major risks that could go against the EU". Their arguments are based on a range of positive outcomes for the EU from the EU–China strategic partnership that could prepare the ground for a reciprocal dialogue.

The EU has been carefully constructing its single market rules and integrative policies, which also provide for shaping the entity's interconnections with other economic areas, including partnerships of strategic importance (i.e. strategic partnerships with the USA, China, Japan, Republic of Korea, Canada, and others). It can be easily predicted that the EU–China cooperation in the process of the BRI's implementation will be requiring compromises in different areas and some serious work to be done by both sides on legislation adjustment. However, there is always a belief that the new era that is dawning over the EU and China will be one of opportunities and positivity.

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China's OBOR as a Geo-Functional Institutionalist Project

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Abstract: *This study analyses the feasibility of China's One Belt, One Road (OBOR) initiative from an institutionalist perspective. The initiative is undertaken as a 'geo-functional institutionalist' project, and this strengthens its feasibility. Firstly, the initiative aims to institutionalize a new international structure paralleling the existing Western-dominated one through which China could re-organize its position as an 'agenda entrepreneur' in the world without any clash with the West. Secondly, the initiative follows a functionalist strategy. It offers a 'win-win' functionalist framework without any hegemonic ambition; thus, the initiative attracts the attention of the rest of the world. China also follows a pure functionalist and bilateral/regional way to deal with the heterogeneity problem among the target countries. However, China's institutionalization attempt might be isomorphic with the existing Western-dominated system in terms of its hegemonic structure due to the cognitive limitations in finding alternatives, and this might ruin the feasibility of the initiative.*

Keywords: *China, functionalism, institutionalism, New Silk Road, One Belt, One Road initiative*

1. Introduction

When the Chinese president Xi Jinping announced the One Belt, One Road (the OBOR) initiative as a global connectivity and infrastructure construction project in 2013, it sounded more like a political ambition than a feasible project. The project aims to connect 65 countries with 4.4 billion people via its two legs: the land-based Silk Road Economic Belt, which would connect China to Europe via Eurasia and the oceangoing 21st-Century Maritime Silk Road, which would enhance connectivity between Asia, Africa and Europe (Du, 2016). In the following years, China put the OBOR initiative in practice; however, its feasibility is not yet clear. Particularly, the initiative, as a new institutionalization attempt, is an ongoing process without any concrete blueprint; thus, the gradually emerging outcomes of this institutionalization process determine the fate of the initiative. Therefore, this paper aims to analyse the feasibility of the OBOR initiative from an institutionalist perspective.

The paper mainly argues that the OBOR initiative is governed as a 'geo-functional institutionalization' process. To explain its geopolitical aspect, the first section will focus on the point that China is a deliberative actor behaving according to its national interests in the international arena. As a deliberative actor, China considers 'relative gains' in the Western-dominated asymmetric world system, but as the Rational Choice Institutionalism (RCI) argues, the interdependence in the Sino-West relationship encourages China to cooperate with the West. However, its deliberativeness still pushes China to find alternatives to deal with the asymmetric nature of the mentioned interdependence in the Sino-West relationship. Put differently, China wants to become an 'agenda entrepreneur' instead of maintaining its status in the world as an 'agenda abider'. At this point, the OBOR is designed in a way that gives China a chance to become an agenda entrepreneur in the world. In this regard, the focal point of this design is functionalism, through which the OBOR offers a 'win-win' cooperation framework to the rest of the world. Thanks to this functionalist framework without any hegemonic ambition, China has already achieved capturing the attention of other countries. In line with this framework, China also follows a bilateral/regional strategy to get rid of the problems that might stem from the heterogeneity among the target countries. Another positive outcome of this functionalist strategy is that China might institutionalize an alternative structure in the world paralleling the existing Western-dominated system without any clash with the West. Therefore, the second section of the paper will focus on the OBOR's functionalist nature by considering the abovementioned arguments.

In conclusion, the paper argues that the China-led institutionalization process (the OBOR initiative) is feasible but fragile. Although this paper puts emphasis on the nation state's deliberativeness, China has indeed a limited capacity to make a precise calculation about the alternatives to the Western domination. Thus, the ongoing alternative institutionalization process might be isomorphic with the existing Western-dominated one in terms of its hierarchical shape (a Chinese hegemony similar to the Western hegemony), and if this possibility happens, China's fragile cooperation with the already suspicious and heterogeneous partners might easily collapse. Moreover, from a theoretical point of view, this case study also shows that institutional change might endogenously take place in an international structure via its deliberative members contrary to the mainstream 'new institutionalist' assumption that change is only possible through exogenous shocks in an international structure. Therefore, this case study suggests that we should not be obsessed with 'individual-society' analogy (highly popular in the new institutionalist school of thought) to understand the nation state behaviour but look for different case studies to obtain much information directly derived from the real life.

2. China as a deliberative dependent in the Western-dominated system

China's OBOR initiative is a good indicator showing that nation states are deliberative actors in the existing world system/structure; thus, this deliberativeness gives them the potential to trigger a change in the structure in which they practise. This means that contrary to the mainstream 'new institutionalist' assumptions, institutional change might be endogenous to a structure via its deliberative actors. However, as RCI assumes, interdependence prevents deliberative actors from showing any radical behaviour, but they might become entrepreneurs of any endogenous change when they acquire the necessary competence. In this regard, the OBOR initiative is an outcome of China's deliberativeness in the Western-dominated international structure, and it was designed as a geo-functional institutionalist project aiming for a gradual endogenous change in the system.

Since the 1970s, IR scholars have focused mainly on 'structure' to explain the nation state behaviour and they, in fact, try to explain 'continuity' in the international system rather than 'change'. For example, in his seminal book, *Theory of International Politics*, Waltz (1979) as a leading realist IR scholar re-conceptualized anarchy as a system that significantly affects the nation state behaviour. In the same vein, Keohane (1984) argued that cooperation among nation states is possible via interdependence as an outcome of international institutions without a need for a hegemon contrary to the 'hegemonic stability theory'. Subsequently, 'new institutionalism' as a new influential school of thought adamantly stressed that international structure has a determining role in the nation state behaviour. According to the new institutionalist logic, the existing international structure is in stasis as nation states have a tendency to cooperate. Briefly, Rational Choice Institutionalism (RCI) tries to explain stasis in the structure via 'interdependence', Historical Institutionalism (HI) via 'path-dependence', and Sociological Institutionalism (SI) via 'logic of appropriateness' (Hall & Taylor, 1996; Schmidt, 2010). Thus, according to the new institutionalist approaches, 'change' is exogenous to any existing structure (Harty, 2005; Olsson, 2016; Gorges, 2001). Particularly, Historical and Sociological Institutionalist approaches agree on the depiction of the nation state as an unconscious dependent of any international structure (Hall & Taylor, 1996; Pollack, 2009); thus, exogenous shock emerges as the best explanation for any institutional change (e.g., see Wendt, 1999). However, China is a deliberative actor aiming to endogenously change the existing Western-dominated system (without replacing it) through achieving parallel institutionalization. This means that these approaches cannot provide a sufficient theoretical framework to understand the OBOR initiative, but RCI might provide some useful insights for a better explanation of this case since this approach perceives the nation state as a deliberative actor in the international environment.

RCI mainly argues that high alternative costs and interdependence drive deliberative nation states to cooperate (Axelrod & Keohane, 1985; Keohane & Nye, 1989). In this sense, 'iteration' in the nation state behaviour is proposed as a convincing theoretical explanation (via game theories) to show how the nation state rationally learns that cooperation is more profitable than deception (Axelrod, 1984; 1997; Oye, 1986). Therefore, this logic assumes that nation states focus on 'absolute gains' instead of 'relative gains' in any international cooperation (Keohane, 1984). According to this static theoretical scenario, China should accept its 'agenda abider' role in the Western-dominated international system due to interdependence in the Sino-West relationship and behave accordingly, but the OBOR initiative is actually a manifestation showing that China refuses this passive role and wants to become an 'agenda entrepreneur' in the world. Therefore, contrary to RCI's assumption, China's behavioural pattern supports the realist argument that 'relative gain' is a significant factor affecting the nation state behaviour in the international system (see Barbieri, 1996; Copeland, 1996;

Grieco, Powell, & Snidal, 1993; Grieco, 1988; Waltz, 2000). Particularly, if the interdependence between nation states is institutionalized in an asymmetrical way, this asymmetrical structure gives significant power to dominant partners, and thanks to this power, some dominant players might demand to change the rules of a game in the middle of it (or in the following phases). Therefore, the disadvantageous sides need to consider 'relative gains' in any international cooperation.

If we analyse the Sino-West relationship from this theoretical framework, we can understand better why China needed to launch the OBOR initiative. As noted above, the Sino-West relationship was institutionalized in an asymmetrical way due to the West's domination over the world, and this gave the West power to intervene in the world system any time they want. In practice, this happened in the 1990s at the expense of China's national interests. The victory in the Cold War gave the West an illusion that they can intervene in the affairs of any country in the name of 'human rights' by infringing the 'sovereignty principle'. To illustrate, Tony Blair (1999), the then British prime minister, declared 'the doctrine of the international community' arguing that the democratic Western countries should launch military operations against the states infringing fundamental human rights; and in the following era, this new doctrine was adopted to legitimize Kosovo, Afghanistan and Iraq wars. China strongly opposed any idea to replace the 'sovereignty principle' with 'human rights' (Feigenbaum, 2008, p. 100; Shen, 2012, p. 195). Therefore, as a deliberative nation state, China did not obey the changing rules in the international system for normative reasons, and was highly irritated by the Western domination in the system. However, China's dependence on the Western capital and technology for economic growth forced it to cooperate with the West despite being extremely uncomfortable with the West's new interventionist doctrines which were weakening the 'sovereignty principle' in the international system (Feigenbaum, 2008; Pan, 2012). As a result, interdependence (with high alternative costs to China) in the Sino-West relations made China an unwilling agenda abider in the Western-dominated international system (Ding, 2010; MacDonald, 2016; Stephens, 2015). On the other hand, the asymmetric nature of this interdependence forced China to consider the 'relative gains' in its cooperation with the West (or as a deliberative nation state, China sought any chance to get rid of this asymmetrical structure).

As a result, after acquiring enough competence, China launched the OBOR initiative as a good synthesis considering both China's dependence on the West and its need to eliminate the asymmetrical nature of this dependence. Therefore, the OBOR initiative might be perceived as a strategic 'soft' behaviour of China to gradually increase the country's power in the world. As Nye (2004) argues, interdependence might force the nation state to behave in a soft way; however, this softness might involve ‘strategic behaviour’. At this point, the main strategy behind China’s behaviour is to institutionalize an alternative system paralleling the existing Western-dominated one without any clash with the West due to China’s dependence on the West (high alternative costs prevent a direct clash between China and the West). Moreover, the OBOR initiative is designed as a ‘functionalist project’, which strengthens the feasibility of the initiative. Firstly, the initiative offers a ‘win-win’ framework without any hegemonic ambition; thus, it has a capacity to develop a polycentric world system (as an alternative to the existing system under the control of the Western hegemony). Secondly, China also follows a pure and bilateral functionalist strategy, which might help the country to successfully handle the heterogeneity problem among the target countries. In the light of these arguments, the following section will analyse the feasibility of the OBOR initiative in depth.

3. The OBOR as a parallel institutionalization process against the Western domination

As noted above, nation states are deliberative actors in the international system, and interdependence encourages them to cooperate with each other. However, unlike RCI’s assumption, it does not actually result in stasis in an international structure because the asymmetric nature of interdependence gives the advantageous side the power to change the rules of the game, and as a response to this, the other side needs to consider ‘relative gains’ in the existing system. However, the consideration of ‘relative gains’ by deliberative nation states does not necessarily lead to a clash among them. The disadvantageous side might attempt to make an endogenous change in the system in favour of itself without any direct clash (or any immediate attempt to ravage the existing system) since any radical behaviour might turn out to be more costly. At this point, China’s OBOR initiative is a good case supporting this argument. On the one hand, China wants to achieve a new form of institutionalization paralleling the existing world system without a clash with the West due to its dependence on the West. On the other hand, the initiative implicitly challenges the Western domination in the international system. Therefore, the OBOR initiative might also be defined as an outcome of China’s ‘subversive action’[1] which takes place in the existing international structure. However, the achievement of this geo-functional institutionalist project depends on the challenger’s entrepreneurial

[1] For more information about what is ‘subversive action’ see Olsson, 2016.

competence and its ability to convince other states.

Firstly, the empirical facts show that China has entrepreneurial capacity to make the initiative feasible. To illustrate, Xi Jinping started to implement a much more proactive foreign policy to create/shape an external environment consistent with China's national interests compared to his predecessors (Chang-Liao, 2016; Zhang, 2015). Additionally, the formation of a National Security Commission might be seen as a concrete Chinese plan to strengthen its global governance capacity (Hu, 2016). Moreover, many scholars agree on the point that China has an oversupply in capital goods and construction-oriented industrial sectors, which could be used for the OBOR initiative (Baviera, 2016; Karim, 2015; Swaine, 2015; Wang, Zheng & Liu, 2016). Related to this argument, China's outward direct investment already exceeded 1 trillion US dollars as of 2015 (MOFCOM, 2016). Last but not least, China managed to institutionalize a sufficient financial system which is necessary to carry out the OBOR initiative. In this sense, the most important one is the Asia Infrastructure Investment Bank (the AIIB) with a capital of 100 billion dollars, founded by 57 countries, and its rich capital and numerous participants make it a real international development bank (Du, 2016). Especially the participation of the Philippines and Vietnam, with whom China has a territorial dispute in the South China Sea, in this financial structure might be seen as a significant functional/financial success of the initiative. Therefore, the establishment of the AIIB has already put China at the centre of geo-economics and geopolitics in the region and beyond (Yu, 2016). China also created the Silk Road Fund with a capital of 40 billion dollars as a medium and long-term development and investment fund, which is open to any country involved in the OBOR (see www.silkroadfund.com).

Secondly, the implementation of the project via a 'win-win' oriented functionalist framework gets positive feedback from other nation states, and this significantly increases the feasibility of the initiative because a 'win-win' oriented functionalist project alleviates the 'relative gains' problem in the international system. Particularly, in a similar way to how the cooperation on steel accelerated the European integration process, China wants to use 'steel' (via train routes or harbours at this time) to trigger a new institutionalization process. However, China's functionalist initiative is different from the functionalism implemented in Europe, which was constrained by a hegemonic ideology (liberal democracy) and regional contiguity. Therefore, in David Mitrany's words (1966), it could be argued that China only offers 'technical self-determination' to other nation states in the world, and the exclusion of geographical and ideological rigidities might make 'common action' more feasible in this project (Mitrany, 1948).

Moreover, the spill-over in the Chinese initiative only represents the expansion of economic prosperity among sovereign states rather than the formation of a political community via diluting nation states' sovereign power. Put differently, China aims to achieve cooperation among nation states but not harmony, and cooperation can even occur in a situation where there is "a mixture of conflicting and complementary interests" (Axelrod & Keohane, 1985). In a concrete manner, for example, the initiative aims to create shared transport links without intervening in the relevant countries' production structures (Ferdinand, 2016), which means that a convergence of complementary interests among the related countries is enough for China to implement the OBOR initiative (and this is also an implicit answer to the question how China will govern trade among highly heterogeneous countries). In this regard, the OBOR initiative might be defined as an 'actor centred' functionalist process (Pierson, 2004), in which actors (nation states) could focus on their own individual interests with less collective responsibility. Related to this argument, Garcia (2014; 2016) also mentions a potential Sino-centrism as an outcome of the OBOR initiative because the connection of Europe and China via the New Silk Road Belt, and Latin America and China via the Maritime Silk Road might trigger a new kind of 'industrial revolution'. However according to him (Garcia, 2014; 2016), this Sino-centrism might be considered as a polycentric world system because it does not constitute any periphery zones like those in the Eurocentric world system. As an example supporting this argument, a White Paper published in 2008 (The State Council of the PRC, 2009) acknowledges 'economic globalization and world multipolarization' as the main parameters of the currently changing world.

As another example, China Development Bank argues that the initiative is being governed according to four principles: openness (the initiative is open to any country), inclusiveness (no conditionality to participate in it), mutual benefits, and participation (every participant is part of the decision-making process) (Zhigang, 2015, p. 6). Thus, these principles might be seen as a manifesto promising that the initiative is being carried out as an 'actor centred' functionalist process with a high respect for sovereignty. In addition to the exclusion of any hegemonic idea, this functionalist initiative is also a global project excluding any geographical contiguity although China's surrounding area has a primary focus. In this regard, China's attempts to connect Latin America to the initiative might be given as a good example, and thanks to these efforts, China became the second biggest trade partner of Latin America ahead of the EU as of 2015 (EC DGT, 2016). Moreover, China follows bilateral/regional arrangements rather than multilateral decisions, which is an effective strategy to get around the problems stemming from the heterogeneity among the target countries. For example, China, as the biggest investor in Africa as of 2015 (ECN, 2015), recently signed an agreement with the African Union on an infrastructure construction project aiming to connect 54 African countries to each other (Chen, 2016). As another successful bilateral/regional arrangement, China managed to initiate a loose institutionalization process with 16 Central and Eastern European countries (see CEEC, n.d.). Moreover, thanks to its bilateral functionalist framework, China could focus on the technical expansion of the initiative despite the significant geopolitical considerations on it. For example, one might explain Russia's and Iran's support for the initiative as an ideological/geopolitical position against the West. However, compared to its partners, China tries to follow a more impartial and technical way to integrate the West to the East. To illustrate, unlike Russia, China does not want to use the Shanghai Cooperation Council as an anti-Western security bloc but to transform it into an economic framework as well (Marketos, 2009, p. 61; Yuan, 2010). Moreover, China tries to deepen its cooperation with Iran in the comity of the West (Garver, 2016). As another example to China's functionalist position, the country tries to avoid being thrown in the loop of the Middle East's sectarian conflicts. Thus, it aims to deepen its relationship not only with Iran but also with the Gulf countries. In this sense, China initiated '1+2+3' cooperation mode[2] in order to develop its relations with the GCC, in which priority is given to energy cooperation; then, to two important fields: infrastructure construction and trade-investment facilitation; and thirdly, to the cooperation on hi-tech (Lirong, 2015). Last but not least, China not only aims to avoid irritating the West while implementing the OBOR initiative but also wants to include the West into its institutionalization attempt to make the initiative more feasible. In line with this purpose, China has already achieved to grab Germany's attention as a pivotal EU member. For instance, Markus Ederer (2016), State Secretary for the Federal Foreign Office of Germany, sees the initiative strategically feasible; thus according to him, Germany and the EU should be part of it. German Deutsche Bahn also agreed with China to initiate rail freight transport from Hefei to Hamburg via Eurasia in September 2016 (see Deutsche Bahn, 2016).

Despite the arguments in this section showing the feasibility of the OBOR initiative, there are also some significant challenges which make the initiative fragile. If the OBOR initiative is an attempt to parallel the existing Western-dominated system, we need to know its relationship with the existing one. In this regard, from a HI perspective, the OBOR might be isomorphic with the existing one (a hierarchic structure) because of the cognitive limitation about

2 This is also another example for China's bilateral/regional strategy.

prospective alternatives (see Fields, Dimaggio & Powell, 1983), and there are two points making this theoretical argument considerable in this case. Firstly, the initiative is an ongoing process and we cannot anticipate the future phases of it. Secondly, as noted above, we know that the OBOR initiative is more like an 'institutional bricolage' than a brand-new invention as its institutionalization depends on both the exploration of new arrangements (e.g., the AIIB) and the exploitation of the existing system (e.g., technological and capital accumulation through cooperation with the West) (De Jong, 2013); therefore, its relationship with the existing system via exploration and exploitation might be open to the mentioned isomorphic effect. In a concrete manner, China tries to initiate a polycentric institutionalization process as an alternative to the West-centred institutionalization in the world. However, Sino-centrism as a hegemonic core might emerge in the coming phases of the process and this possibility will most probably ruin the abovementioned gains of the initiative. In this regard, there is already suspicion about the mentioned possibility in China's surrounding area (e.g., India and Japan) (Fujiwara, 2016; Li-juan, 2016; Siling, 2015). Moreover, this alternative institutionalization process is fragile against exogenous shocks. For example, Russia's reaction to the Western domination in the international system, which drives China to develop a 'soft power' project, is different since Russia prefers to directly challenge the West and tries to compete with the Western institutions through alternative institutionalization projects such as Eurasian Economic Union (Dragneva & Wolczuk, 2012; Vilpisauskas, 2016, ch. 15). Therefore, as Russia has its own agenda for Eurasia, its lukewarm but crucial support for the initiative might be lost at any phase of the initiative (Ferdinand, 2016; Wilson, 2016). The geopolitical tension in the South China Sea has also the potential to spoil the initiative despite the inclusion of the Philippines and Vietnam in the AIIB (Yu, 2016).

4. Conclusion

This paper analyses China's OBOR initiative from an institutionalist perspective and argues that the initiative is designed as a 'geo-functional institutionalist' project. As RCI assumes, China is a deliberative actor in the Western-dominated international system, and thanks to this deliberativeness, it takes into account the 'relative gains' in the system. However, as RCI argues, the dependence of China on the system prevents it from displaying any marginal behaviour, but the asymmetric nature of its dependence pushes China to find an alternative. At this level, the OBOR initiative stands for this alternative because it aims at new institutionalization paralleling the Western-dominated international system without any direct clash with the West. Moreover, the findings of the study support the argument that the OBOR initiative is a feasible project. Firstly, China has sufficient competence to carry out this functionalist project. To illustrate, the foundation of the Asia Infrastructure Investment Bank is a good indicator showing this competence. Secondly, its functionalist strategy improves the feasibility of the project. On the one hand, the OBOR initiative has a 'win-win' framework without any hegemonic ambition; thus, it is attractive to the rest of the world. This framework also does not have any geographical limitation, which strengthens its global agenda. Thus, the influence of China is on the rise both in Africa and Latin America. On the other hand, China follows a pure functionalist and bilateral strategy to overcome the heterogeneity problem among the target countries. To illustrate, thanks to its bilateral strategy, China managed to cooperate with both Iran and the Arab states of the Persian Gulf despite the loop of the Middle East's sectarian conflicts. Although these advantages strengthen the feasibility of the OBOR initiative, it is still a fragile project mostly because of the fact that the hierarchic structure of the existing international system might have an isomorphic effect on China's initiative due to the cognitive limitations in finding alternatives. Therefore, if the OBOR initiative starts to get a hierarchic structure, the mentioned gains might easily be lost.

The findings of this research might also be attributed to the institutionalist discussions on the concept of 'change'. In particular, the explanation of 'change' remains an important puzzle for new institutionalism (James, 2016). In this regard, as noted above, new institutionalist assumptions mainly focus on exogenous shocks to explain institutional change. However, this case shows that change might endogenously take place in an international structure through its deliberative actors (nation states) once they acquire enough competence to achieve this. However, the study also acknowledges that deliberativeness itself is not enough to explain the nation state's behaviour; thus, we need deeper analyses to make it more knowledgable. In this respect, it might be a better idea to re-visit 'agency-structure' problem in the IR discipline (Carlsnaes, 1992; Wendt, 1987). Particularly, as new institutionalists do, an individual-society analogy might be helpful in understanding the nation state behaviour in the international arena to some extent; however, any further obsession with this analogy might drive us into a fallacy as the nation state as an actor in the international arena is a sui generis entity, and more importantly, every nation state has also unique traits. This means that they might react differently under the same international conditions. As noted above, for instance, China and Russia have different reactions to the Western domination in the international system. As a result, this study argues that more case studies focusing on different nation states might enrich our knowledge of the nation state behaviour since macro-level theoretical assumptions might prove limited in explaining the real life.

Assistant Professor Dr **Yilmaz Kaplan** has an MSc degree in Politics (European Studies) from Lund University, Sweden, and a PhD degree in Politics from University of York, UK. His main research interests are the European integration, the EU enlargement, globalization, and (new) institutionalism.

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How Do Cultural and Institutional Distance Affect China's OFDI towards the OBOR Countries?[1]

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Abstract: *In order to examine the impact of cultural and institutional distance on China's OFDI towards the One Belt, One Road (OBOR) area, the paper selects 28 countries along The Belt and Road. The empirical results using panel data from 2006–2014 indicate that institutional distance is negatively correlated with China's outward foreign direct investment (OFDI). At the same time, cultural distance interacts with bilateral trade, resulting in a "benefit of foreignness" effect.*

Keywords: *cultural distance, institutional distance, OBOR, OFDI*

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1. Introduction

The Silk Road Economic Belt and the 21st-Century Maritime Silk Road are the initiatives first introduced by China's President Xi in 2013 during his visits to Kazakhstan and Indonesia, respectively. Now they are known as The Belt and Road or One Belt, One Road (OBOR). OBOR includes 65 countries which jointly account for 62.3%, 30.0% and 24.0% of the world's population, GDP and household consumption, respectively (Chin & He, 2016, p. 4). The Belt and Road initiative aims to promote the connectivity of Asian, European and African continents and their adjacent seas, establish and strengthen partnerships among the countries along the route (NDRC, 2015).

At present, the world economy is recovering slowly and global development is uneven. Also, the international trade and investment rules for multilateral trade and investment are undergoing major adjustments. It is the key stage of economic transformation for Asian and European countries. Therefore the developmental vitality and cooperation might play a significant role in that area. The OBOR initiative is exactly the common demand for those countries, and it also provides new opportunities for cross-country cooperation and growth through opening up to other countries. Chinese enterprises have made direct investments to 50 countries along OBOR and the amount reached 18.93 billion dollars in 2015.The investment flow increased 38.6% year-on-year, which is twice the growth rate towards the world. By the end of 2015, the stock of Chinese direct investment in the OBOR countries reached 115.68 billion dollars, accounting for 10.5% of total Chinese direct investments stock (Ministry of Commerce of PRC, 2016, p. 92). Thus, we could conclude that those OBOR countries will become the new growth source for China's outward foreign direct investment (OFDI).

Currently we can already see some achievements in the cooperation of energy equipment and infrastructure between China and those countries. Due to great differences in the scale of economy, industrial structure and trade volume, Chinese investments have mostly been injected in Southeast Asian countries or Russia, having resulted in serious imbalance of investments in the OBOR region. Besides, there are quite complicated security concerns such as different powers, religions, cultural conflicts embedded in that region, which would further increase the risks of future cooperation in investments. Against such background the study of cultural and institutional distance on China's OFDI will have great significance for bilateral investments between China and these countries and further extend the cooperation to realize risk sharing and win-win situation for all related countries. Cultural distance is defined as the difference between the national culture of the home country (China) and those of the host economies (Yuanfei & Fuming, 2012, p. 49). It measures the extent to which normative forces influence FDI activities. Institutional distance is the extent of similarity or dissimilarity between home and host countries' institutions (Kostova, 1997). Therefore, we refer to institutional distance as an absolute distance between institutions in destination and China.

The remainder of the article is arranged as follows. Section 2 describes literature related to our research and our possible contribution to the literature. Section 3 introduces the situation and characteristics of China's investments in the OBOR countries. Section 4 investigates the effects of cultural and institutional distance on China's OFDI by constructing a gravity model and discusses empirical results, and Section 5 concludes the article.

2. Review of literature

This paper is motivated by a broad literature on the location choice of investment by multinational enterprises. Scholars mainly research developed countries to analyse the motivations of their enterprises in investment activities; Dunning's eclectic paradigm suggests three primary motivations behind international investments of firms from developed countries as market-, efficiency- (or cost reduction) or resource- (or strategic asset) seeking. Apart from the above motivations, they have started to pay attention to the cultural or institutional factor of the host country on attracting foreign investments.

2.1 Cultural distance and FDI

Studies have showed mixed results in terms of the relationship between cultural distance and OFDI till now. FDI is particularly sensitive to 'soft' barriers, such as the quality of governance systems and cultural differences, firms substitute FDI by trade when cultural differences between the parent and the home country increase (Lankhuizen *et al.*, 2011). Xu and Li (2011) indicated that cultural distance is negatively correlated with China's OFDI, that is to say, the greater cultural difference between China and the host country, the less direct investment from China to the host country. Flores and Aguilera (2007) arrived at the same conclusion in their research on how US multinational corporations made location decisions referring to overseas direct investment. In contrast, some empirical researches suggest that firms from dissimilar cultures are more prone to undertake FDI into emerging markets than more similar ones (Thomas & Grosse, 2001; Randy & Dibrell, 2002). While at the early stage of FDI, cultural distance is negatively associated with its choice of location, the influence of cultural distance may become weaker in the later stage. Yin and Lu (2011) suggested that it is not simply negative or positive correlation of cultural distance on the location choice of foreign investment, and it is not linearly displayed, and by integrating the effects of "liability of foreignness" and "benefit of foreignness", the result indicates an S-shape relationship between cultural distance and FDI flows.

2.2 Institutional distance and FDI

Institutional distance has recently been identified as a major factor that affects multinational enterprises' (MNEs) entry mode choices since the countries' differences are perceived "as a barrier to obtaining local knowledge, making it difficult for the MNE to manage its foreign subsidiaries on its own" (Xu & Shenkar, 2002, p. 613). In addition, it has an asymmetric effect on FDI depending on whether investors choose countries with better or worse institutions. In the latter case, large institutional distance discourages FDI inflows, but this deterring effect is diminished for destination countries with substantial resources (Aleksynska & Havrylchyk, 2013). Using the distinction between formal and informal institutions, Dikova and others (2010) have found that firms undertaking M&A deals in institutionally more distant countries are more likely to withdraw the deal. Since politically distant target countries could increase the complexity of the deal. Chinese OFDI tends to be less risk averse, Buckley and others (2007) found that most Chinese OFDI was government led and promoted by political affiliations and connections between China and other developing host country governments. Therefore, they suggested that China's OFDI is attracted to natural resources in high (political) risk countries. While other studies tend to show limited evidence linking Chinese OFDI and an uncertain political/institutional environment (Cheung & Qian, 2009; Kolstad & Wiig, 2012), Ramasamy and others (2012) indicated that the driving force for China's OFDI may be different in terms of the ownership. State-controlled firms are attracted to countries with large natural resources and risky political environments and private firms are more market seekers.

Furthermore, by protecting property from political and other risks, bilateral investment treaties (BITs) could substitute for weak domestic institutions and promote FDI flows to developing countries (Neumayer & Spess, 2005; Busse *et al.*, 2010). However, the effect of a BIT crucially depends on the quality of political relations between the signatory countries; it increases FDI more between countries with tense relationships than between friendly countries (Desbordes & Vicard, 2009). Also BITs are more effective in promoting firms to locate in signatory countries with a worse institutional environment (Zong *et al.*, 2012). Li and others (2014) show that the institutional distance suppresses China's OFDI. However, BITs not only reduce barriers for China's enterprises to go out, but also have a significant reverse regulation on the suppression of institution distance.

For the empirical exercise, we focus on the impact of both these two aspects: how culture and institutions affect Chinese firms' location choice of investment along the Belt and Road region. Our paper contributes to a growing literature that analyses the determinants of Chinese outward foreign direct investment by selecting 28 OBOR countries between 2006 and 2014.

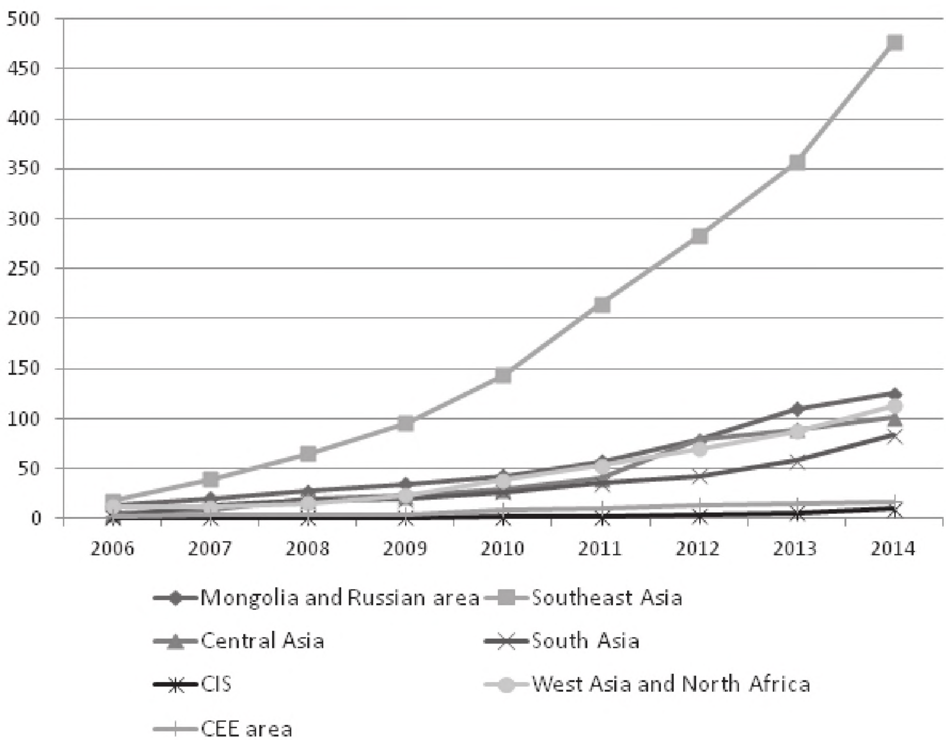
3. Characteristics of China's OFDI towards the OBOR countries

With its economy entering the state of "new normal", China is witnessing a dramatic change from a capital importing country to a capital exporting country. Outward investment from China rose by about 4% to 128 billion dollars (UNCTAD, 2016, p. 48). As a result, China remained the third largest investing country worldwide, following the United States and Japan. According to the data from the Ministry of Commerce, Chinese non-financial investment in 2015 amounted to 118.02 billion dollars, a growth of 14.7% year-on-year, and continuing growth in outbound investments over the past 13 years (*Xinhua*, 2016). In recent years, private enterprises have become the main driving forces with investment diversity and upgrade of their position within global value chains. Technology-seeking OFDI from China in recent years is likely to intensify and necessitate upgrading of the industrial structure, while Chinese investments will also contribute to the development of host economies, especially in developing countries that share some basic features with China and have investment needs that the country is well-suited to match (OECD, 2015, p. 21). That explains the rapid increases of Chinese investment flow to the OBOR regions to some extent.

3.1 The size of investments extends further

Chinese investments in the Belt and Road region are extremely unbalanced and have three levels in general. By the end of 2014, investment stock flows in Southeast Asia reached 47.63 billion dollars (see Fig. 1), average growth rate up to 51% during the period between 2006 and 2014, and the area ranked first in attracting investments among those OBOR countries.

Figure 1. China's outward FDI stock in the OBOR initiative area (100 million US dollars)



Source: Statistical Bulletin, 2015

It was followed by Mongolia and Russia (12.46 billion dollars), West Asia and North Africa (11.304 billion dollars), Middle Asia (10.094 billion dollars), CIS (9.332 billion dollars) and South Asia (8.227 billion dollars), and the 16 CEE countries[2] came last, attracting only 1.7 billion dollars of Chinese investments, less than 4% that of in Southeast Asia.[3]

Among these regions, Middle Asia has relatively faster growth rate in attracting investment from China, reaching 26.9% year-on-year from 2006 to 2014.[4] This is partly due to sufficient oil resources in that area, especially in Kazakhstan. As to the CEE countries, although the FDI stock is the lowest, it grew approximately fortyfold in 2014, compared with 2003. And we could expect it will grow even faster in the future as both parties explore new space for cooperation in green economy, i.e. green agriculture, ecological environment protection and clean energy under the improved 16+1 cooperation mechanism. In addition, Southeast Asia has the most investments from China in the background of OBOR. This is not only due to the free trade zone agreement signed between China and ASEAN but also because they are culturally and geographically closer.

3.2 More firms invest in the area

According to Figure 2, the investments of Chinese enterprises mainly went to ASEAN. Until the end of 2015, there were 48.4% Chinese firms who chose Southeast Asia as a host country for investment. Next to Southeast Asia, the Mongolia and Russian area attracted around 17.1% of firms.[5] It is almost in the same trend compared with the scale of investments attracted. Although Chinese enterprises increased investments in CEE countries since the establishment of the 16+1 cooperation framework in 2012, only 1.6% enterprises joined in. For individual countries, Russia, Singapore and Vietnam are top three in terms of attracting Chinese firms' investment, accounting for 11.4%, 8.9% and 8.4%

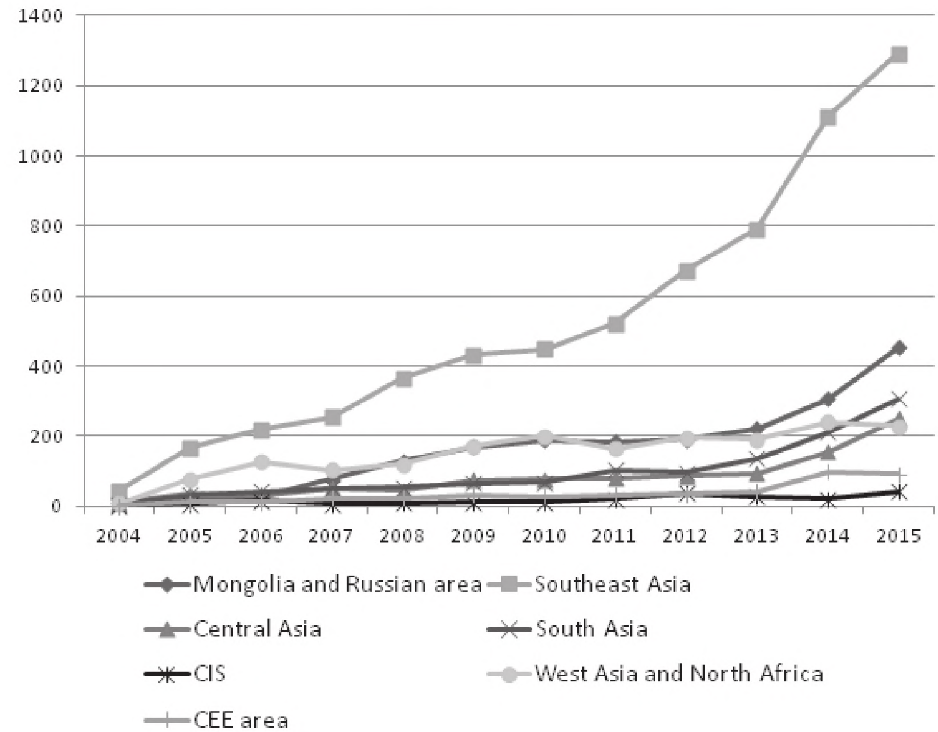
[2] *Mongolia and Russian area* refers to Russia and Mongolia; *Southeast Asia* includes Singapore, Malaysia, Indonesia, Myanmar, Thailand, Cambodia, Vietnam, Brunei, the Philippines, East Timor, Laos; *West Asia and North Africa* include Iran, Iraq, Turkey, Syria, Jordan, Lebanon, Israel, Palestine, Saudi Arabia, Yemen, Oman, the United Arab Emirates, Qatar, Kuwait, Egypt, Bahrain; *South Asia* includes India, Pakistan, Bangladesh, Sri Lanka, Afghanistan, Nepal, Maldives, Bhutan; the *Commonwealth of Independent States* includes Ukraine, Georgia, Azerbaijan, Armenia, Moldova, Belarus; *Central Asia* includes Kazakhstan, Uzbekistan, Turkmenistan, Kyrgyzstan, Tajikistan; the *Central Eastern European countries* include Poland, Romania, Czech Republic, Slovakia, Bulgaria, Hungary, Latvia, Lithuania, Slovenia, Estonia, Croatia, Albania, Serbia, Macedonia, Montenegro, Bosnia and Herzegovina.

[3] Author's own calculation based on data from *Statistical Bulletin*, 2015.

[4] Author's own calculation based on data from *Statistical Bulletin*, 2015.

[5] Author's own calculation based on data from the Chinese website *Zhiqiye*, n.d.

Figure 2. Investment track from China to the OBOR countries (no. of investments)



Source: Author's own calculation based on data in Zhiqiye (n.d.)

respectively (NDRC, 2015). Therefore, although Chinese firms have invested in more countries in recent years, cultural, institutional and geographical distance are still the main factors affecting the choice of location for investment abroad, and they are more inclined to invest in countries with cultural and geographical proximity.

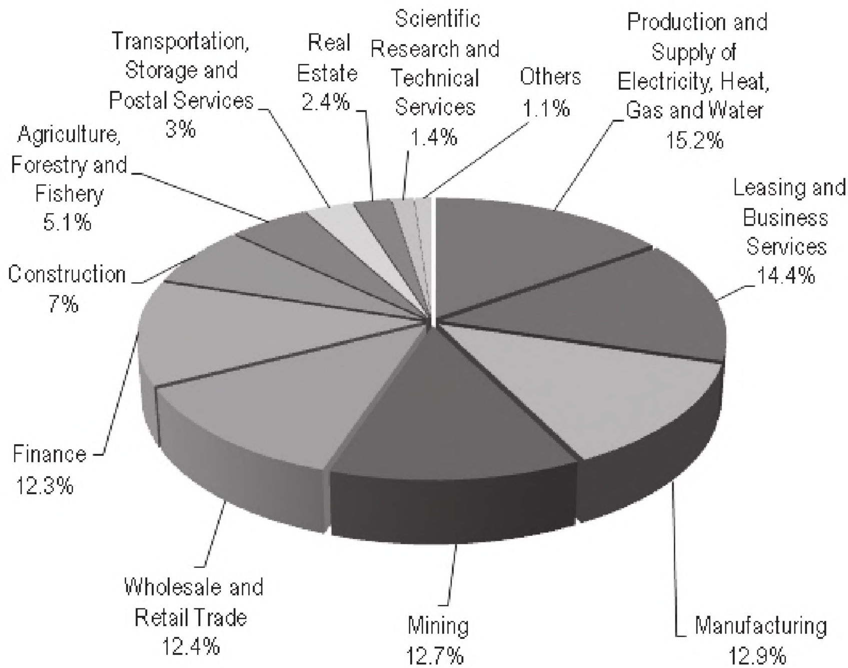
3.3 Investments scattered in different industries

In 2014, China's outward FDI flows to ASEAN reached 7.81 billion dollars, increasing 7.5% year over year and accounting for 51.5% of its outward FDI stock in the OBOR region. By the end of 2014, China had established more than 3,300 FDI enterprises which created 159,500 jobs for those countries (*Statistical Bulletin*, 2015, pp. 116–117). In terms of industrial structure of China's FDI stock in ASEAN in 2014, there were 7.23 billion dollar flow in the production and supply of electricity, heat, gas and water, accounting for 15.2% of the total (see Fig. 3), and the stock had been mainly distributed in Singapore, Myanmar, Cambodia, Indonesia and Laos. This is mainly due to the difficulty in providing electricity to households in some countries in the area, for example, only 56.1% of people had access to electricity in Cambodia in 2014 (World Bank, 2014). While Chinese enterprises have comparative advantage in supplying hydro and thermal electricity, for example, China Huadian Corporation have invested in a number of facilities which have been put into operation, including Indonesian Batam power plant, Indonesian Bali coal-fired power plant, Asahan Stage-I hydroelectric power station and Lower Stung Russei Chrum—the largest hydropower project in Cambodia (China Huadin Corporation, n.d.).

The second was leasing and business services, which received 6.84 billion dollars from China, accounting for 14.4% of the total, followed by manufacturing (6.13 billion dollars), mining (6.05 billion dollars), wholesale and retail trade (5.9 billion dollars) and finance (5.88 billion dollars). Leasing services, retailing and finance investments were mainly distributed in Singapore, manufacturing in Vietnam and Thailand, and natural resources in Indonesia and Laos, etc. Under the China–Singapore Free Trade Agreement, China and Singapore enhanced cooperation in financial services: in 2013, for example, the People's Bank of China (PBC) appointed the ICBC Singapore branch as the Renminbi (RMB) clearing bank in Singapore. Together with its transparent public institutions and highly efficient public sector, it is not surprising that Singapore attracts most finance investments from China among ASEAN countries.

Chinese investments in Mongolia and Russian area have turned from the extraction of traditional nature resources to business and financial services. Until the end of 2014, China's OFDI stock in Russia had reached 8.695 billion dollars, accounting for 12.5% of its OFDI stock in Europe, among which leasing and business services and finance accounted for 11.3% and 8.8% respectively. Although the ratios of the above two were still lower than that of manufacturing, which was 31.6%, in terms of the capital flows in 2014, leasing and business services attracted up to 15.9% investment in total (*Statistical Bulletin*, 2015, p. 122). In CIS and CEE countries, apart from intensive investments in infrastructure, there were increasing capital flows to electronics, software, information and finance industry.

Figure 3. Industrial distribution of China's FDI stock in ASEAN, by the end of 2014



Source: Statistical Bulletin, 2015

4. Methodology and results

4.1 Variable measurement and data

Given the availability of data, we selected the panel data of 28 host countries[6] along OBOR from 2006 to 2014, and our main focus was to investigate how cultural and institutional distance affects location choice of Chinese multinationals. In addition, considering the impact of transportation costs, trade and purchasing power, we included trade, GDP per capita and the interaction term of geographic distance and bilateral trade as control variables. Each variable is explained as follows:

The dependent variable is FDI stock from Chinese firms in each host countries. We chose FDI stock instead of FDI flows to these economies, as the stock variable is a more accurate measure of FDI location distribution (Filippaios, Papanastassiou & Pearce, 2003; Yuanfei & Fuming, 2012). Data for the dependent variable were obtained from official Chinese sources (MOFCOM), namely *Statistical Bulletin of China's Outward Foreign Direct Investment*.

Cultural Distance (*CD*). It is defined as the difference between the national culture of China and these of the 28 host economies. It is measured by means of Hofstede's (1983) four cultural dimensions of power distance, uncertainty avoidance, individualism/collectivism and masculinity/femininity. Following the method developed by Kogut and Singh (1988), cultural distance was measured by the squared deviation along each of the dimensions of each country from China's score. Then the deviations are corrected for differences in the variances for each factor. The index is as below:

$$CD_{ij} = \frac{1}{4}\sum_{k=1}^{4}((\mathrm{I}_{ki} - \mathrm{I}_{kj})^2 / \mathrm{V}_k) \tag{1}$$

where I_{ki} or I_{kj} represents the score for the k^{th} cultural dimension of country $i\,(\,j\,)$. V_k represents the variance of the score for the k^{th} dimension. CD_{ij} stands for cultural distance of the i^{th} country with respect to country j. Thus, a high score on the measurement means more cultural distance between China and country i. Hofstede's scale are collected from the World Values Survey (WVS) website.

[6] It includes Russia, Singapore, Malaysia, Thailand, Philippines, Iraq, Turkey, Jordan, Lebanon, Yemen, Qatar, Kuwait, Egypt, Bahrain, India, Pakistan, Ukraine, Georgia, Azerbaijan, Armenia, Belarus, Uzbekistan, Kyrgyzstan, Tajikistan, Poland, Romania, Slovenia and Estonia.

A potential problem about this measurement lies in the fact that it assumes that each cultural dimension has the same effects on cultural distance for different country or regions. However, with globalization, cultural conflicts may be narrowed. To overcome this difficulty, we modify the index as below referring to Qi (2012) and Tian (2015):

$$CD_{ij} = \sqrt{\sum_{k=1}^{5}((\mathrm{I}_{ki} - \mathrm{I}_{kj})^2 / \mathrm{V}_k) + (1/Y_{ijt})} \tag{2}$$

where Y_{ijt} represents years of the establishment of diplomatic relations between country i (i.e. China) and country j, since the longer the relationships, the smaller the cultural distance. Also, we choose Hofstede's five cultural dimension model to overcome the problem of its overreliance on the survey of IBM employees.

Institutional Distance (*ID*). It captures both regulative and normative aspects of institutional environments. It is based on the World Bank's Worldwide Governance Indicators (WGI), which cover six dimensions, namely, voice and accountability, political stability, government effectiveness, control of corruption, regulatory quality and rule of law. Here, the former four aspects indicate the normative distance between two countries while the latter two show the regulative difference. We measure the institutional distance between China and the OBOR countries using the following formula:

$$ID_{ijt} = \sqrt{\sum_{k=1}^{6}((\mathrm{I}_{kit} - \mathrm{I}_{kjt})^2 / \mathrm{V}_{kt})} \tag{3}$$

where I_{kit} (I_{kjt}) represents the score for the k^{th} dimension of country i (j) in year t, and V_{kt} refers to the variance of the score for the k^{th} dimension of all countries.

Bilateral trade (*TRADE*). Both the export from China to a host country and import from a host country capture the intensity of trade relations. Also, it indicates the relations between trade and investment, whether it is complementary or substitution. The data comes from UN Comtrade database.

GDP per capita (*AGDP*) indicates the purchasing power of the local population or host country's market size, and the data come from the World Bank's World Development Indicators.

The interaction term of geographical distance and bilateral trade ($\ln DIS_{ijt} * \ln\mathrm{TRADE}_{ij(t-1)}$). Distance (*DIS*) is the product of distance from the capital of China (Beijing) to the host country's capital and the average annual price of crude oil from OPEC during 2006–2014. The geographical distance data is drawn from CEPII weighted distance. The purpose of constructing the new distance variable is to capture the costs for transportation due to geographical distance. With this term, we are able to test how geographical distance affects firms' investment location choice in the OBOR region via trade. Considering that the substitution for investment may lag behind the trade, we introduce trade lagged by one year.

4.2 Estimation strategy

Following the discussion on variables above, we formulated the regression model as follows:

$$\begin{aligned}\ln OFDI_{ijt} = \beta_0 + \beta_1 CD_{ijt} + \beta_2 ID_{ijt} + \beta_3 \ln \mathrm{TRADE}_{ij(t-1)} \\ + \beta_4 \ln AGDP_{jt} + \beta_5 \ln DIS_{ijt} \cdot \ln \mathrm{TRADE}_{ij(t-1)} + \mu\end{aligned} \quad (4)$$

where i represents China, j refers to host county. Our dependent variable is the total amount of China's OFDI stock to host countries.

Our panel data includes time invariant geographical distance which captured by country fixed effect, which is why the distance variable did not show up in Table 2. In addition, a year fixed effect is controlled to isolate the time trend of FDI stock in case of the estimates are overbiased. Therefore, by controlling both year and country fixed effect, we are able to control the impact of country-specific characteristics and some unobservable time-related factors on FDI stock.

Table 1. Descriptive statistics

Variables	Mean	S.D.	Min	Max	Samples
$\ln OFDI_{ijt}$	18.2469	2.554229	12.50618	23.75049	252
CD_{ijt}	4.784077	1.091072	2.785037	7.089988	252
ID_{ijt}	8.183551	8.146696	0.8327145	40.3962	252
$\ln DIS_{ijt}$	13.07314	0.3796044	11.98016	13.6907	252
$\ln \mathrm{TRADE}_{ijt-1}$	22.22871	1.739615	16.96739	25.38749	252
$\ln AGDP_{jt}$	8.711454	1.158096	6.636629	11.21787	252

Table 1 provides descriptive statistics for the abovementioned variables. China's FDI stock in host country ranges from 0.27 million dollars (12.5 in logarithm form) for Bahrain in 2006 to 20.6 billion dollars (23.75 in logarithm form) for Singapore in 2014. The relatively large standard deviation of investment stock shows a big difference in attracting China's investment in that region. Also the large standard deviation of bilateral trade and per capita GDP indicates that the trade relations and market size are quite different as well. Besides, the cost of geographical distance has relatively small standard deviation.

4.3 Results and discussion

Table 2 presents results on how cultural distance and institutional distance between China and the host countries shape the patterns of Chinese outward investment to the OBOR area. We do find that the estimated coefficient for institutional distance is negative and statistically significant. Similarly, trade relationship casts a negative impact on location choice of Chinese FDI, indicating the substitution between these two activities. Besides, the interaction term of geographic distance and trade is significant at 5%. We now discuss each of these main findings in more detail.

Cultural distance has a strong influence on the location choice of Chinese FDI towards the OBOR region. The negative sign of the variable indicates its impact exerted on Chinese OFDI. This result suggests that Chinese firms would prefer FDI locations where a small cultural distance existed between China and the host countries. However, it is not statistically significant in our results. This is partly due to the short period of our observation, in which culture is unlikely to change greatly. Therefore, the variation in FDI stock caused by cultural distance is insignificant. The interaction term between cultural distance and bilateral trade is significant, suggesting that the "benefit of foreignness" (i.e. differentiation of products) has played an important role in explaining the motive behind Chinese OFDI.

We find that the coefficient on the institutional distance indicates a negative relationship between institutional distance and Chinese FDI since greater institutional distance increases the costs of doing business in a foreign country, because it is associated with greater uncertainty and non-familiarity with the local environment. We can infer from the estimation results that if the institutional distance increases by one unit, it is associated with a decrease in Chinese FDI by 10.1% (model 1).

Bilateral trade is negatively significant at 1%, indicating that trade substitutes Chinese FDI towards the host countries. The positive sign of interaction between geographical distance and trade suggests that the greater geographical distance resulting in higher trade costs leads to more Chinese firms entering into the host country by direct investment instead of trade. Surprisingly, the coefficient of host country's GDP per capita is insignificant, which suggests that Chinese investment in the OBOR regions is not motivated by market-seeking. For example, BYD Auto Corporation built an electric bus factory in Hungary and it is planned to produce the bus chassis for the UK. The central location and engineering excellence are the reason for BYD's investment (BYD Europe, n.d.).

Table 2. Empirical results

Variables	$\ln OFDI$				
	(1)	(2)	(3)	(4)	(5)
CD	2.669	-4.593	-1.489	-8.656	-9.312
	(9.318)	(9.66)	(9.573)	(9.914)	(9.879)
ID	-0.101***	-0.10***	-0.99***	-0.100***	0.339
	(0.032)	(0.031)	(0.032)	(0.031)	(0.262)
LnTRADE	0.089	-4.142**	-1.341*	-5.009***	-5.108***
	(0.163)	(1.645)	(0.734)	(1.716)	(1.709)
LnAGDP	0.638	0.620	0.807	0.785	0.666
	(0.627)	(0.619)	(0.632)	(0.625)	(0.626)
CD*lnTRADE			0.722*	0.142*	0.120
			(0.413)	(0.084)	(0.085)
ID*lnTRADE					-0.020*
					(0.012)
lnDIS*lnTRADE		0.314**		0. 318**	0.349***
		(0.127)		(0.126)	(0.127)
Country	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes
N	252	252	252	252	252
R-squared	0.685	0.694	0.689	0.698	0.702

*Note: Standard errors are in parentheses; ***, ** and * indicate that the coefficients are significant at the 1%, 5% and 10% levels, respectively.*

5. Conclusions

This paper is one of the first attempts to formally model Chinese OFDI towards the OBOR countries. Our motivation is to test the extent to which cultural and institutional distance affect Chinese OFDI. Based on the panel data of China's investment stock in the OBOR region from 2006 to 2014 and using fixed effect regression model, our main findings are consistent with the conventional theory explaining emerging country's FDI. Institutional distance plays a significant role in shaping Chinese investments towards the OBOR countries. This finding suggests that Chinese MNEs are targeting FDI location where it has smaller differences in institutions. Furthermore, the impact of culture interacts with bilateral trade. Given trade relationships and the preferences over differentiated goods based on cultural difference in the host country qualify Chinese firms for benefits. Finally, with greater geographical distance and increasing trade costs, Chinese MNEs tend to enter a host country by investment instead of trade.

The policy implications of our findings are that to facilitate the cooperation mechanisms for the Belt and Road initiative, we should pay more attention to institutional differences among countries. Especially for transition and developing economies as FDI recipients, the governments should focus on strengthening economic institutions in attracting FDI.

Despite the above contributions, we believe that our study has some limitations that can be addressed in future research. One limitation of this study is that due to the availability of data, we focus on the analysis on the country level. Results based on aggregate statistical data make it difficult to determine the various impacts of culture on investment for products with different intensity factor, since some products are culture-intense (i.e. shooting movies) while others are insensitive to culture changes (i.e. digital products). Thus, research at industry or even firm level may be helpful in solving this problem in the future.

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Export Promotion Aims and Reality: A Comparison of the Iberian, Baltic and Central European Region[1]

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Abstract: *As a consequence of the international crisis in 2008–2009, the role of exports in economic growth came into focus in most countries. Exports of EU Member States gained momentum from 2010 onward but with certain changes in their structure and direction. In several countries, the turn towards non-EU areas, such as China or Latin America was part of the state export strategy. On the one hand, our article describes these foreign trade strategies and their institutional framework of the Iberian, Baltic and Central European governments, detecting possible similarities. On the other hand, we analyse recent export data. This way we can get a picture on the structure and direction of exports of periphery economies and this can be compared to the aims of the given states.*

[1] The article was prepared on the basis of a research paper by Antalóczy and Éltető (2016) supported by the National Research, Development and Innovation Office, project no. K115578, titled 'Factors influencing export performance—a comparison of three European regions'.

Our hypothesis is that there is a gap between the reality and the intentions of the governments. The size of this gap varies and is influenced by certain factors such as the different involvement of multinational companies in foreign trade or the different economic structure of these countries. In our paper we list which countries adopted a government strategy and with what aim. We provide a short literature review on state trade promotion policies and discuss these policies and their institutions in the Baltic, Visegrád and Iberian countries.

Keywords: *comparative studies of particular economies, empirical studies of trade, international trade organisations, trade policy*

1. Export promotion policy

The international crisis in 2009 caused a shrinkage of domestic demand and a general credit crunch. As a consequence, export became an important factor of possible growth in the majority of EU countries. In this context, state export promoting policy became relevant. In most cases the ratio of export per GDP has increased after the crisis in the EU countries.[2]

There exists considerable literature on trade promoting institutions, strategies and their effectiveness in general. Several empirical articles try to correlate export growth and promotion measures (e.g., Rose, 2007; Nitsch, 2005) and others show the results of questionnaire surveys (e.g., Kotabe & Czinkota, 1992; Singer & Czinkota, 1994). In general, the state can stimulate export via 'soft' interventions and by direct financing (credits, subsidies).

Diplomacy and export promotion programs belong to *the 'soft' group* (Van Biesebroeck *et al*., 2015). Exports of a given country are facilitated by its consulates and embassies abroad. Rose (2007) applying a gravity model of 22 countries (including Spain and Poland) and 200 destinations shows that the presence of foreign missions is indeed positively correlated with exports. The extent of correlation varies by exporter, and the first foreign mission has a larger effect on exports than successive missions.

[2] Between 2007 and 2015 the share of exports of goods and services in GDP of the Visegrád group increased from an average 67% to 80%, in the case of the Baltic group from 51% to 72% and for the Iberian countries from 28% to 37% (Eurostat data).

Business delegations and heads of state visits can also promote economic relations (export and investment). Evidence of their export-raising effects is mixed for certain large countries in the post-state visit periods, when higher export was detected (Nitsch, 2005); however, the findings of Head and Ries (2010) do not confirm such effect in the case of Canada. Similarly, the meta-analysis of Moons and van Bergeijk (2013) conclude that the literature on the impact of economic diplomacy on trade is rather ambiguous.

Regarding state export promotion programs and agencies, their primary role is to provide information to firms and help them reduce transaction costs. The efficiency of export promotion agencies is generally debated. In some cases positive effects can be found and in other cases effects are non-significant (see literature review in Durmuşoğlu *et al*., 2012).

An important and relevant question is whether the state promotion programs could mitigate the negative impacts of the 2008 crisis, helping firms to recover. By the example of Peru and Belgium, Van Biesebroeck and others (2015) provided evidence that firms who received export support during the crisis performed better. They were more likely to remain active on export markets and exported higher volumes relative to control firms. The authors found that the effects were stronger for exports outside the EU for Belgium and the effects were particularly strong at the extensive margin (entering of new exporting firms). As shown in the article, the expenses on export promotion have been very small compared to the export value of the countries.

Export is a complex task, involving several risks. Regarding *direct export financing,* payment should be secure and timely, possibly not costly, adequate financing method should be selected. Commercial, bank and country risks can be various (non-payment, damaged goods, political, economic and exchange rate measures in the target country, etc., Malaket, 2014). State help in any of these factors can be very useful, especially for SMEs. Sometimes, private export credit insurers are not willing or able to cover all the risks (especially for large, long-term and risky transactions).

Usual agents of export financing are credit and insurance providing companies. Governments establish public Export Credit Agencies (ECAs) to mitigate financial constraints and risks in exports. Export credit insurance facilitates the export transaction, directly or indirectly, by securing the financing aspect. Not many studies have been prepared about the effectiveness of ECAs in stimulating exports, but recently there is increasing theoretical and empirical evidence that the activities of ECAs have a positive effect on exports (see articles cited by Janssen, 2016).

Any export strategy is part of the general economic policy of a country, export promoting institutions are part of the general institutional system. Below we focus on state policies announced especially after the crisis. We describe government strategies (if they exist) targeting export development and reforms in main export promoting institutions. We mention, but do not go into details of export financing/credit institutions.

2. Practice of promotion, similarities, and differences

In all nine countries of the Baltic, Visegrád and Iberian regions, important government strategies concerning export promotion were announced around 2011–2012 as a reaction to the crisis (see Table 1). 'Made in Estonia 3.0' is Estonia's action plan for the years 2014–2017 for increasing the export capacity of Estonian companies and involving foreign investments (Estonian Ministry of Economic Affairs and Communications, 2014). It is in connection with other strategies and development plans. The action plan sets the following goals: increase Estonia's importance in world trade, increase export turnover across all target countries by at least 10% per year, increase the number of exporters and growth in average export unit price. The Export Development Strategy 2009–2013 intended to expand the opportunities of firms to find new trading partners. The next strategy (for 2014–2020; Ministry of Economy of the Republic of Lithuania, 2015) was adopted in 2015 and it establishes export promotion policy and measures. Its priority objectives are (1) to maintain export positions in foreign markets; (2) to penetrate into new markets, especially in third countries; and (3) to promote the export development of higher value-added goods and services.

We have not found separate export promotion strategy of the Latvian government, but the Industrial Development Policy adopted in 2012 (Ministry of Economics of the Republic of Latva, 2012) deals also with export development. For SMEs, the International Promotion of Competitiveness program has been in force since 2008, supporting enterprises entering into foreign markets during and right after the global financial crisis (EC, 2016).

In Slovakia, no separate export strategy had existed either until 2014. However, the Research and Innovation Strategy focused on export trends and development recognising that in Slovakia the production of motor vehicles and consumer electronics are decisive export sectors and aiming to strengthen their position. Later, the Strategy for External Economic Relations of the Slovak Republic for 2014–2020 was developed by the Ministry of Foreign Affairs in order to boost exports. The Ministry cooperated with the Slovak Investment and Trade Development Agency (SARIO) and the Slovak Chamber of Commerce and Industry to conduct business forums and missions, visits by state officials to EU and non-EU countries.[3]

The Export Strategy of the Czech Republic 2012–2020 (Ministy of Industry and Trade of the Czech Republic, 2012) aims among others to increase the number of exporters, diversify and shift Czech exports into economic sectors with higher added value, and reduce product concentration (Antalóczy & Éltető, 2016).

The export promotion strategy during the crisis was based on four main elements: promotion of brand, economic missions of officials, assistance to Polish firms with information on foreign markets, and financial instruments. In 2016, a most noticeable change is that the support of Polish firms abroad became one of the five pillars of the new general growth strategy (Ministry of Economic Development of Poland, 2016).

The Hungarian export development strategy (called 'Eastern Opening') was adopted in 2011 for the 2012–2015 period. The full text of the strategy was not public, only press information was published about it. The aim was to diversify Hungary's foreign economic relations and developing non-EU relations (towards, for example, CIS countries and China; Government of Hungary, 2011), doubling Hungary's exports and promoting exports of Hungarian SMEs.

The Portuguese government launched a program for internationalisation in 2016 to promote export, attract FDI and support outward investments of Portuguese companies. The Portuguese state promotion for internationalisation is heavily supported by the EU funds. The biggest Operational Programme in Portugal is Competitiveness and Internationalization, which is co-funded with 4.4 billion euros through both Structural Funds, as well as through Cohesion Fund. This means 21% of the available funds for Portugal (EC, 2014).

The Strategic Plan of Internationalisation of the Spanish Economy was approved by the government in February 2014 (*Ministerio de Economía y Competitividad*, 2014–2015). This is a 120-page document outlining the weaknesses and strengths of Spanish external sector and setting development aims, measures and tools. The plan is based on six axles: (1) improving negotiating and business

[3] In 2013, aiming to increase exports from SMEs, SARIO together with other institutions launched a project called Misia 14 – Made in Slovakia. Firms were encouraged to express their opinions on problems with exports via an online questionnaire. (*The Slovak Spectator*, 2013) The results, however, are not known.

climate for firms; (2) improve market access; (3) financial support facilities; (4) trade and internationalisation promotion; (5) human capital development; and (6) innovation promotion. The Strategic Plan describes 41 definite measures, dedicated sums and institutions along the axles to support the defined aims and priorities.

Table 1. State export policies and institutions in the observed countries

	Government strategy for export or internationalisation	'Soft' tools, agencies	'Direct' tools, financing (export credit agency)	Regional promotion	Need for diversification	Importance of innovation, higher value-added connected to export
Estonia	EAS Strategy 2015–2018	EAS	KredEx	weak	geographical	yes
Latvia	No separate strategy Part of Industrial Development Policy	LIAA	ALTUM	no	geographical	yes
Lithuania	Export Development 2014–2020	Enterprise Lithuania	INVEGA	weak	geographical	yes
Poland	New Development Strategy 2016	PaiIIZ/ PAHiI	KUKE	strong	geographical	yes
Czech Republic	Export Strategy 2012–2020	Czech-Trade	CEB, EGAP	weak	geographical and product	yes
Slovakia	Part of Research and Innovation and National Development Strategy. Later, the Strategy for External Economic Relations of the Slovak Republic for 2014–2020	SARIO	Eximbanka	no	geographical	yes
Hungary	"Eastern Opening"	HIPA, trade houses	Exim	no	geographical	no
Portugal	Program for Internationalisation	AICEP	COSEC	weak	geographical	yes
Spain	Strategic Plan of Internationalisation of the Spanish Economy	ICEX	CESCE, ICO	strong	geographical and product	yes

A common feature of post-crisis policies is that the importance of non-EU markets emerges in every country. In *Estonia*, the export target countries are the neighbouring economies (Latvia, Lithuania, Finland and Russia), countries of the Hanseatic Road (Sweden, Norway, Denmark, Germany, Great Britain, France, the Netherlands and Belgium) and faraway markets (the large countries in Asia, USA and Brazil). In *Lithuania*, also three priority export market groups were identified by the government: enlargement markets—Sweden, Norway, Germany, the United Kingdom, France; perspective markets—USA, China, Israel, Japan, Ukraine; and exploratory markets—the UAE, Canada, Turkey and the Republic of South Africa. In *the Polish* development plan there is a focus on some new Asian, African and American markets. New trade posts are to be created in these countries. In *the Czech* strategy, 12 priority countries were defined: Brazil, People's Republic of China, India, Iraq, Kazakhstan, Mexico, Russian Federation, Serbia, Turkey, Ukraine, USA and Vietnam. Another target group covers the so-called "countries of interest", with 25 developing markets[4]. The *Hungarian* foreign economic strategy—even named Eastern Opening Strategy—puts emphasis on developing trade relations with China, India, Russia, South Korea, Turkey, ASEAN member states, Arab countries and CIS. In *Slovakia*, the aim is to increase exports to the EU, the Balkans, CIS, certain countries of the EU's Southern Neighbourhood, and Africa and Asia (Ministry of Foreign and European Affairs of the Slovak Republic, 2014). In the *Iberian* economic strategies, the importance of non-EU emerging markets was also emphasised.

Among the non-EU emerging markets, China is one of the most of important target markets in all the nine countries. After the crisis, economic policy in the Visegrád countries intended to strengthen trade and investment ties with China. Traditionally, Hungary has had the strongest links and the largest Chinese diaspora in CEE, but recently Poland and the Czech Republic also intensified diplomatic missions and common economic projects (Éltető-Szunomár, 2016).[5]

4 Angola, Argentina, Australia, Azerbaijan, Belarus, Egypt, Ethiopia, Chile, Ghana, Croatia, Israel, Japan, South Africa, Canada, Columbia, Morocco, Moldavia, Nigeria, Norway, Peru, Senegal, Singapore, United Arab Emirates, Switzerland and Thailand

5 The Central-Eastern European region also became important for China itself. In 2012, during his visit at the First CEE-China Summit in Poland, the Chinese Prime Minister officially launched a cooperation plan with 16 CEE countries called the Warsaw initiative. The following summits have taken place in Bucharest, Romania (2013); Belgrade, Serbia (2014); Suzhou, China (2015) and Riga, Latvia (2016). Active measures have been taken in investment, trade, infrastructure development to strengthen the ties with the CEE region.

Concerning the export promoting institutions in our three regions, many of them have been reorganised, centralised after the crisis. In Poland and Hungary, this step was radical and followed a previous government change. Regarding institutional system in Poland, the Ministry of Economic Development was created through the merger of Ministry of Infrastructure and Regional Development and, partly, a Ministry of Economy. Instead of the previous dispersed institutions and agencies controlled by different ministries, one greater umbrella-type agency—The Polish Development Fund—was founded. It is controlled by the Ministry of Economic Development. This fund coordinates many other agencies such as the Polish Agency of Enterprise Development, Export Credit Insurance Corporation Joint Stock Company (KUKE), the Polish Agency of Trade and Investment (PAHiI). The budget of this Agency will be almost ten times more (100 million zlots) in 2017 than in 2016 (12 million zlots). (*Ministerstwo Rozwoju*, 2016)

In Hungary, those export promoting and financing institutions that had existed for decades were reformed and centralised. Their direction and ownership was transferred to the Ministry of Economy. Investment promotion is the task of Hungarian Investment Promotion Agency (HIPA, n.d.) and export promotion is the task only of the National Trading House (NTH), established in 2013. NTH has opened trade houses in more than 40 economies,[6] its functioning, however, is not transparent and produces yearly loss. The agency for export financing is EXIM, a merge of the Hungarian Export-Import Bank Plc. (Eximbank) and the Hungarian Export Credit Insurance Plc. (MEHIB).

In Slovakia, the National Business Centre (launched in 2015) serves as an umbrella organisation providing different forms of institutional support to all entrepreneurs interested in expanding their business abroad. It is financed through the operational programme for Research and Innovation and operates via the Slovak Business Agency under the Ministry of Economy.

In the Iberian economies, export promoting institutions were also reorganised to some extent. The main export promoting agency in Portugal is AICEP (n.d.), Portugal Global Trade & Investment Agency created in 2007 (with a merger of API and Icep, former investment and economic promotion agencies), for attracting investors in Portugal and contributing to the success of Portuguese companies abroad in their internationalization processes or export activities. The agency has a global network, provides support services, counselling, tailored information. AICEP Portugal Global Group also includes *AICEP Global Parques*—an industrial parks management entity. As far as export

6 There are a number of faraway countries among them (Botswana, Namibia, Laos, South Africa, Mexico, Peru, Ecuador, Cambodia, Indonesia, Armenia, Kazahstan, etc.).

credit is concerned, the private insurance firm COSEC has the mandate to manage the official export credit guarantee scheme on behalf of the Portuguese government. The government established a Strategic Council for Economic Internationalisation (*Conselho Estratégico de Internacionalização da Economia*, or CEIE) already in 2012 to integrate public and private initiatives.

The main state agency for Spanish export promotion is ICEX.[7] It has an extensive internet homepage (ICEX, n.d.) and a large network of offices both within Spanish regions and abroad. ICEX launched at its homepage the so-called *Ventana Global* ('Global window'), which offers all public services and information[8] in integrated form with direct access for exporting and investing companies. In 2012, ICEX was reorganised, it integrated Invest in Spain, and later it incorporated also CECO (Commercial and Economic Study Centre) and the state society *España, Expansión Exterior*. This way ICEX became the only anchor for internationalising Spanish firms.

In the Baltic countries, institutional reorganisation occurred only on minor scale. In Estonia, the most important promotion agency is Enterprise Estonia (EAS), founded in 2000. Regarding Export, the credit institution KredEx was founded in 2009. In Latvia, the main institution of export and investment promotion is LIAA (Latvian Investment and Development Agency) which belongs to the Ministry of Economy. Regarding export finance, ALTUM (Development Finance Institution) provides export credit guarantees and insurance. It was started in 2015 as the successor of the Latvian Guarantee Agency, founded in 1998. It is a state joint stock company and administers financial state aid targeting mainly SMEs, start-ups. In Lithuania, the agency Enterprise Lithuania has the task to foster the country's exports. The export guarantee institution (INVEGA) was established in 2001 for SME development and is supervised by the Ministry of Economy.

As government documents show, in all our nine countries (except for Hungary) the governments realised the importance of a coherent economic policy and connected export promotion policy with other development strategies. Innovation, research and development and increasing domestic value added serve as a basis for medium and long-term export development.

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7 It was established in 1982 and had the present abbreviation since 1987, meaning *Instituto Español de Comercio Exterior*. Since 2012 together with organisational changes its official name changed to *ICEX Espana Exportaciónes e Inversiones*.

8 *Secretaría de Estado de Comercio del Ministerio de Economía y Competitividad, ICEX Compañía Española de Financiación del Desarrollo* (COFIDES), *Compañía Española de Seguro de Crédito a la Exportación* (CESCE), *Sociedad Estatal España Expansión Exterior, Instituto de Crédito Oficial* (ICO), *Enisa, Centro para el Desarrollo Tecnológico Industrial* (CDTI).

Certainly we can find important differences among the policies. Government strategies are in some cases very detailed, well prepared and coordinated with other policies (e.g., in Spain, Czech Republic, Estonia) and there are countries where export strategy is only a part of other policies or it is not completely public (in Latvia, Slovakia, Hungary). The level of transparency of state actions is also different. The least transparent is the Hungarian system of trade-houses, but in the case of Portuguese and Spanish export financing agencies concerns have been raised too.[9]

Although the geographical diversification of exports appears everywhere as a policy goal, the aim of product structure diversification can be find only in the Czech and Spanish strategies.

In Spain and Poland—as large countries where the level of decentralization is higher than in small economies—the role of regional export promotion is also important. (Spanish regional governments have established a network of regional export promotion offices abroad[10]). In certain countries, the strengthening of the country brand, country-image came also into focus (*marca Portugal*, *marca España*, *marka Polska*) and became integrated into the export promotion system, while in other cases this was not in focus. Some government strategies (Spain, Poland, Estonia, Latvia) recognised that export promotion is connected to industrial policy and human capital development.

3. Trends in trade

As we have seen above, non-EU export was explicitly promoted by the states. Therefore, in 2010–2011, extra-EU exports increased very dynamically in our observed countries (see Figs. A1–A3 in Annex). However, later on a stagnation or decline of extra-EU exports has been experienced. Although this recent trend is similar across countries, the reasons can be somewhat different.

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9 Portugal: "since May 2010 until January 2014, COSEC did not disclose on its website any information on the projects supported. […] The quality and the quantity of the information disclosed by COSEC do not allow civil society to efficiently monitor its activity." In Spain, CESCE was given legal protection in maintaining strictest confidentiality about data held on the projects they insure (see http://www.eca-watch.org/ecas).

10 Since the mid-nineties there has been a proliferation of these regional offices all over the world. Gil-Pareja *et al.* (2015) found that the activity of these offices had significant effects on aggregate exports.

In the case of the Baltic countries, the main reason for the sharp decline of extra-EU deliveries is that the share of Russia in the total export fell (from around 20% in 2014 to 6–13% in 2015).[11] In the case of the Visegrád countries, extra-EU export increased until around 2012, but later stagnated and slightly declined. There was a significant export volume decrease to Russia, Ukraine, some CIS and African states. At the same time, export towards the EU increased dynamically.

Spanish and Portuguese exports to non-EU areas show a stagnation since 2013, but export to the EU (and total export) increased here also. Among the non-EU areas exports recently decreased to Venezuela, Ecuador, Russia, China, Brazil. Until 2015, Portugal's exports decreased also to Angola, which otherwise had become a promising export market in the last decade. Spanish exports have grown at a much faster pace than GDP since 2010. Spanish companies have become more and more internationalised[12], their presence in China, Latin America and Africa have increased.

Table 2 shows some export markets for our nine countries. All but one among the most important targets are EU members; the exception is Russia which is very significant for Baltic export. For the Iberian economies, France, Germany, Italy and UK are the most important export markets and for Portugal, the neighbouring Spain is by far the most relevant. In the case of the Visegrád countries the export dependency on Germany is apparent. Of exports, 25–30% are directed to Germany from each country (and these are only the direct deliveries, indirect exports via each other for example elevate this dependency even more). For the sake of comparison, the share of China (PRC) is also given in total manufacturing exports. The table shows that in those countries where the activity of foreign multinational companies is significant, the weight of China is larger in the exports.[13]

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11 From 2014, the Russian countersanctions against the EU sanctions involved an embargo on several agricultural and food products, including meat, dairy products, fruit, and vegetables. The export of the Baltic and Visegrád states have been significantly affected by the countersanctions. Apart from the countersanctions, other developments of the common agricultural policy in the EU, the depreciation of the rouble, the economic slowdown in Russia also had an effect on exports to Russia.

12 There were 99,000 exporting firms in 2009 and 147,000 firms in 2015 (García-Legaz, 2016).

13 As Eurostat data for 2015 show, in Portugal and Slovakia there is a huge product concentration, 40% and 64% of exports to China consists of motor vehicles, in Hungary 14% of exports to China consists of piston engines (all deliveries of the local Volkswagen group plants). The largest Polish exports item to China (33%) is copper and copper ores are also significant in the export of Portugal (12%) and Spain (4.8%). Copper is the base material of electric circuits and other products made in China.

Table 2. Main export partners and the export-weight of China in the observed countries, 2015 (% of total exports of goods)

Latvia		Estonia		Lithuania	
LIT	17.75	SWE	18.81	RUS	13.66
RUS	11.44	FIN	16.00	LAT	9.83
EST	11.05	LAT	10.35	POL	9.72
GER	6.24	RUS	6.65	GER	7.80
POL	5.54	LIT	5.85	EST	5.33
PRC	0.99	PRC	1.17	PRC	0.45

Czech Rep.		Slovak Rep.		Hungary		Poland	
GER	32.41	GER	22.65	GER	28.03	GER	27.14
SK	8.97	CZ	12.49	ROM	5.42	UK	6.76
POL	5.84	POL	8.52	SK	5.12	CZ	6.60
UK	5.27	AUS	5.68	AUS	4.98	FRA	5.54
FRA	5.10	HU	5.68	IT	4.76	IT	4.77
PRC	1.16	PRC	1.50	PRC	1.42	PRC	1.02

Spain		Portugal	
FRA	15.57	SP	24.98
GER	10.89	FRA	12.13
UK	7.33	GER	11.82
IT	7.32	UK	6.72
POR	7.06	US	5.15
PRC	1.74	PRC	1.68

Source: Eurostat Comext database

Everywhere among the most important five export partners we can find neighbouring countries. This shows the reinforced importance of intra-regional trade. Regarding shares in foreign trade, *the Baltic countries* have the strongest strengthening ties with each other. Here we should mention re-exporting as an important part of trade in the Baltic countries (*Lietuvos Bankas*, 2014; Benkovskis *et al*., 2016; Kerner 2012). The main reason for that is that given the small size of the countries, logistics chains treat the Baltics as one region. In

Baltic ports, firms often operate warehouses serving more than one of the Baltic States. A main direction of re-export is the Russian market and an important exports item are petroleum oil products.[14]

Regarding the intra-regional trade of *the Visegrád countries*, here the activities of global production networks or value chains (GVCs) is the most important drive. The Visegrád countries export large volumes of automotive, telecommunication, electrical and metal products to each other within the intra-firm trade of multinational companies. As is known, Hungary, the Czech Republic and Slovakia are especially strongly linked to global value chains (see Éltető, 2015 and the studies cited there). Inclusion into GVCs is usually measured by the foreign value added content of exports based on world level input–output tables. Naturally, as foreign value added in exports increases, the domestic value added decreases. Antalóczy and Éltető (2016) calculated the share of domestic value added for the period of 1995–2011 for the nine countries. The most radical decrease (from 66% to 48%) can be observed for the Visegrád economies and the bulk of this decrease took place before 2005 as a consequence of economic liberalisation and FDI inflow during the nineties.

The importance of intra-trade within *the Iberian countries* is asymmetrical for the two countries. Portugal is much more dependent on Spain than vice versa, and the trade balance is increasingly favourable for Spain. Three factors are important in intra-Iberian trade: natural geography, re-export and global production chains. Bordering regions in the two neighbouring countries have an important role in mutual trade. Galicia has the highest trade volume with Portugal, followed by Andalusia, Castile and León, and Extremadura (Pérez Castro *et al.*, 2015). Similarly to the Baltic countries, the ports in Portugal play an important role in re-export. In the largest, deep sea port of Sines there is a big oil refinery of Galp Energia built in 1971 and it has become a major energy hub.[15] Portugal does not have own crude oil, it is dependent on imported oil. Despite this, petroleum products are the leading export items of Portugal to the EU (mainly Spain), indicating re-export activity. Intra-Iberian trade has been also boosted by the growing local activity of global value chains. Amador and Stehrer (2014) analysed

[14] Petroleum oil products are leading export items in other cases too. In Estonia, Russian oil is exported to other countries through Estonia's ports. In Lithuania, refining oil is also important—PKN Orlen Lietuva is the most significant supplier of petrol and diesel fuel in the Baltic countries, its products are also exported to Western Europe, USA, Ukraine, and other countries.

[15] Sines has a good chance to attract traffic to and from Madrid, from vessels not calling at Mediterranean ports or for shippers targeting to trade directly with South American and African markets. Sines port also hosts the only LNG terminal of Portugal.

Portuguese integration into GVCs between 1995 and 2011, demonstrating the strengthening of Iberian GVCs.

Based on the data we can confirm that significant geographical diversification of exports has not taken place, despite government intentions. Diversification of product structure has not taken place either, as the concentration indices calculated by Antalóczy and Éltető (2016) prove; in fact, in several cases exports have become less diversified after the crisis.

4. Conclusion

After experiencing the negative effects of the international crisis in 2008–2009, each country recognised the importance of export as a motor of growth. The Baltic, Iberian and Visegrád economies have become much more export-dependent. Export promotion became a state policy aim with an own strategy in most cases. In these documents the strengthening of export to non-EU areas is generally an important goal, emerging target markets, such as China are named. However, trade data show that the share of EU in exports decreased only temporarily and slightly, after which it regained its previous position.

The slowing down of the emerging markets is, of course, one external factor behind this phenomenon. Our paper, however, examined the internal reasons of this "return to the EU". We showed the importance of intra-regional trade, partly based on re-export. Foreign trade of the examined periphery countries is still structured around the neighbours (Russia, Sweden for the Baltic countries, France, UK, Italy for the Iberian countries, and Germany as almost a unique hub for the Visegrád countries).

Most exporting firms in these economies are part of global value chains. These GVCs are directed by foreign multinationals, the activity of which cannot be really influenced by local governments.[16] Good state policies recognise this and try to create a favourable economic environment and incentives for domestic firms to gain adequate positions within GVCs. In the Slovakian case, for example, the strong export dependence on cars and components was accepted by the state, and more domestic value-added production was promoted within the automotive production chains. Most government development strategies aim small and medium sized firms, sometimes explicitly targeting national companies.

[16] This trade-determining role of GVCs is the most apparent in the trade with China.

Although product diversification was also a policy aim in certain countries, concentration has not changed significantly. This shows that export diversification is a long-term process and concentration also largely depends on the massive deliveries of suppliers into GVCs.

Studies and surveys show that the evaluation of state promotion policies is mixed. Information services and cost financing are the most important for exporting companies. According to our opinion, an export strategy can only be effective if it is part of a coherent economic policy, it is transparent and provides a stable environment for the firms. The development of human capital is also essential in this respect.

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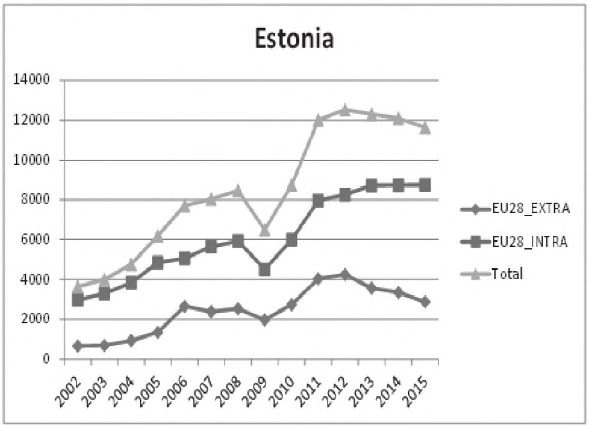
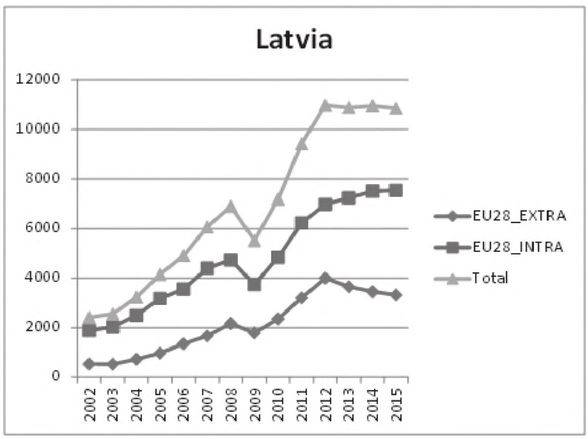
ANNEX

Figure A1. Export to EU and non-EU areas, Baltic countries





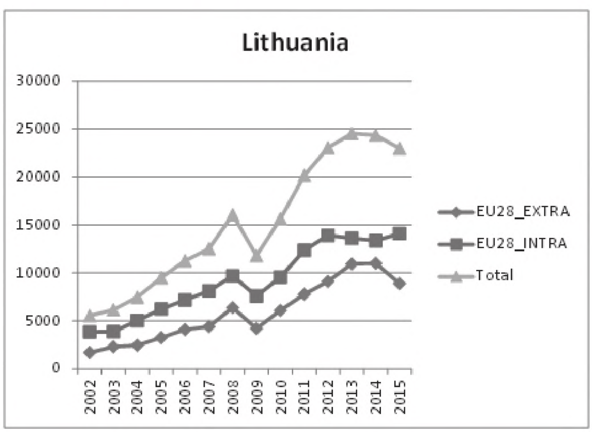


Figure A2. Export to EU and non-EU areas, Visegrád countries

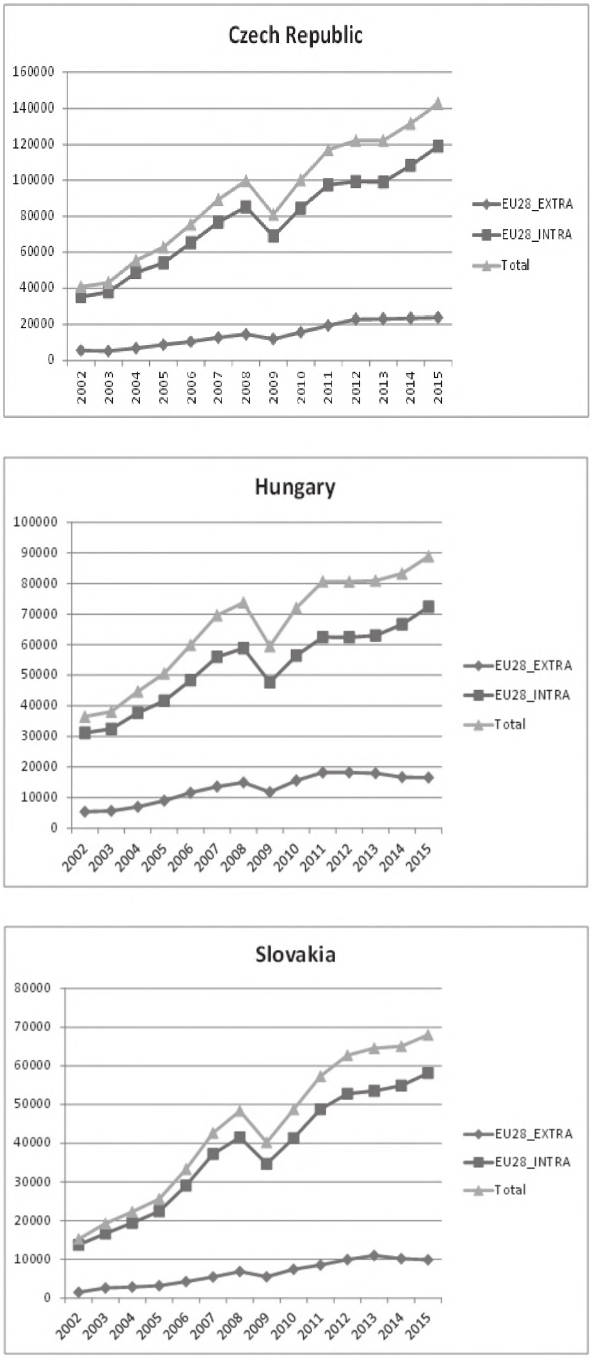
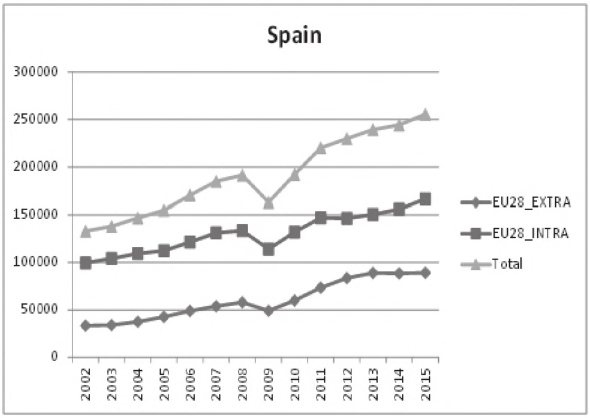
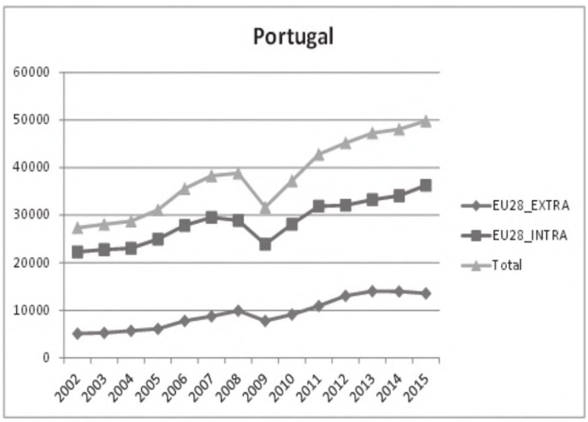


Figure A3. Export to EU and non-EU areas, Iberian countries





Source: Eurostat Comext

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Chinese Investments in Serbia—A Joint Pledge for the Future of the New Silk Road

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Abstract: *Following the political changes in 2000, Serbia has rapidly started to catch up with the countries of Central and Eastern Europe in various aspects of the transition process. One of these very important aspects were foreign investments, both 'direct' and 'portfolio' ones, that had a significant impact on the development of Serbian economy by recovering economic structure and raising competitiveness in world markets, followed by improving the balance of payments and technological, scientific and managerial base. Foreign investments as an "economic engine" enable accelerated realization of national economic goals which include re-industrialization and renewal of industrial capacity. The openness of the Serbian market and the lack of financial resources allow China and other states concerned under favourable conditions invest in the development of Serbian economy. In this way, Chinese investments have become a driving force for the promotion of economic and other relations between the two countries. On the other hand, however, Chinese investments have proven to be an ideal test for the realization of the objectives of the development strategy of the 'New Silk Road' which among other things include the improvement of China's position on world markets, including the EU market. For the proper understanding of Sino-Serbian relations, this study first gives a short explanation of the Chinese strategy of the New Silk Road. Then, it includes an analysis of Serbia's position towards China. Analysis of the development of Serbian-Chinese economic relations, especially in the field of foreign investment and within the framework of multilateral cooperation mechanism '16+1', occupies the central part of the study. The study concludes with an* *evaluation of comparative advantages and certain disadvantages for the Chinese foreign investment in Serbian economy, which in itself has certain significance for the realization of the New Silk Road strategy.*

Keywords: *16+1 mechanism, China, development strategy of the New Silk Road, foreign investments, Serbia, the Belt and Road initiatives*

1. Introduction to China's New Silk Road development strategy

China's tremendous economic development has made the country an increasingly attractive economic partner in the first and second decade of the 21st century. During this period, the ancient Silk Road trade route became attractive once again. Its symbolism in different geopolitical circumstances served China as the ideological basis for the proliferation of ideas of the New Silk Road, which has become, within the political paradigm of the "Chinese dream", the leading national development strategy. Building on the earlier proclaimed policy of the 'Peaceful Development', this strategy conceptually shaped China's efforts to consolidate the regional security and to ensure harmonious economic development of most of the world. This strategic concept of Chinese foreign policy came up together with the economic concept of 'Open door' which was applied in China for more than three decades and led to market-oriented reforms and gradual process of liberalization, from which were removed internal barriers in terms of movement of goods, labour and capital (Hongyuan, Yun & Qifa, 2012, pp. 128ff). From 2000 onwards, China has made significant progress in the global market. Joining the World Trade Organization and strengthening its economic capacity, China has managed to occupy one of the leading positions in the world economy. Unfortunately today, like other global powers, China is facing serious economic threats caused by the world economic crisis and internal social tensions. These problems put aside exports and foreign direct investment as a leading Chinese economic development model. Given the difficult business conditions, China tries to find new export markets or preserve the existing ones. This is the main reason why the New Silk Road has developed in two political framework initiatives expressed through the phrases *the Silk Road Economic Belt* and *the 21st-Century Maritime Silk Road*, which China is usually referred to as *Yi Dai Yi Lu* (One Belt, One Road).

The Silk Road Economic Belt initiative, announced by Chinese President Xi Jinping in September 2013, aims to promote cooperation between China and countries in Asia and Europe according to the new model, which should include:

1) Strengthening policy communication, which may help ‘switch on a green light’ for joint economic cooperation;

2) Strengthening road connections, with the idea to establish a great transport corridor from the Pacific to the Baltic Sea, and from Central Asia to the Indian Ocean, then gradually build a network of transport connections between eastern, western and southern Asia;

3) Strengthening trade facilitation, with a focus on eliminating trade barriers and taking steps to reduce trade and investment expenses;

4) Strengthening monetary cooperation, with special attention to currency settlements that could decrease transaction costs and lessen financial risk while increasing economic competitiveness;

5) Strengthening people-to-people relations. (*Xinhua*, 2013)[1]

On the other hand, the second initiative of the 21st-Century Maritime Silk Road, which was first mentioned by Chinese President Xi in early October 2013, should serve for improvement of maritime economy as well as environment protection, science, technology and security cooperation along the sea routes

[1] Professor Liu Zuokui from the Institute for European Studies of the Chinese Academy of Social Sciences points out that “[t]he Silk Road Economic Belt has three routes on the corridor which refers to the Siberian Continental Bridge (also known as the First Eurasian Continental Bridge), starts from Vladivostok in the eastern part of Russia and ends in Rotterdam in the Netherlands; the New Eurasian Continental Bridge (also known as the Second Eurasian Continental Bridge), begins in Lianyungang in East China’s Jiangsu Province and ends in Rotterdam. It exits China via the Alataw Pass and runs through Central Asia into Russia, Poland, and Germany; the third is the Eurasian Continental Bridge that is now on the drawing board. This proposed route would start from Shenzhen in Guangdong Province and end in Europe via Myanmar, Bangladesh, India, Pakistan, Iran, Turkey and Bulgaria.” (Liu, 2015, p. 186)

of southern Eurasia, from the Pacific coast to East Africa, the eastern Atlantic shores and Mediterranean.[2]

The Belt and Road initiatives have been proposed with the purpose of benefiting both China and the countries along the land and maritime route. They are open to all countries and international organizations (for example, Shanghai Cooperation Organization, the Eurasian Economic Community, Asia–Pacific Economic Cooperation, Asia–Europe Meeting, ASEAN plus China, BRICS, etc.), while adhering to the principles of mutual respect and common interests. The most important common economic interests include the improvement of trade and investment flows (facilitated through greater use of local currencies in cross-border exchange, and through currency swap arrangements between the People's Bank of China and other central or national banks), the improvement of transport infrastructure (the railway and highway network, and the deep water port facilities) and deepening economic integration (greater access to Chinese market for all countries along the route, and *vice versa*) (Dimitrijević & Jokanović, 2016a, pp. 26–27; *Xinhua*, 2015a). In order to achieve these initiatives, China and the states concerned from different continents have established the Asian Infrastructure Investment Bank (AIIB) with an initial capital of 100 billion US dollars earmarked for funding infrastructure projects and promoting regional interconnectivity and integration (*Xinhua*, 2015b).

In line with the published Chinese projections, both of these initiatives are expected to become fully operational by 2025 (Escobar, 2015). These initiatives should boost the revitalization of the large part of the world which covers the vast area with more than 4.4 billion people. It is expected that the total value of these initiatives surpass 21 trillion US dollars (almost one third of the world's GDP) (Janković, 2016, p. 6). The network of investments that includes the Belt and Road initiatives might create the landmark infrastructure projects of the 21st century (World Land-Bridge), encompassing 60 or more countries from different continents (Zepp-LaRouche, 2015, pp. 2ff). The importance of the Belt and Road initiatives is therefore huge, taking into account the number of countries they could encompass and the potential economic benefits for all of them. Hence, the Belt and Road initiatives

[2] According to the recent information published by the *Xinhua* agency, the Maritime Silk Road begins in Quanzhou (Fujian) and hits other southern Chinese ports (Fujian, Zhejiang and Guangdong) before heading to the Malacca Strait. From Kuala Lumpur, the Maritime Silk Road heads to Kolkata, crosses the rest of the Indian Ocean to Nairobi and then around the Horn of Africa into the Mediterranean—with final stops in Greece and Italy.

indicate a positive climate for building a new economic international system that could bring prosperity for a large number of countries that are on the New Silk Road, including Serbia, which, according to its specific position in international relations has a special significance for their implementation.[3] In the following parts of the study, the author will try to present concrete facts concerning these allegations.

2. Serbia's positioning towards the People's Republic of China

Relations between Serbia and China follow the continuity of relations between Yugoslavia and the People's Republic of China that commenced with Yugoslav recognition of China on 1 October 1949. Since the two countries encourage friendly relations with each other and actively participate in the development through various forms of bilateral and multilateral cooperation at the regional, subregional and global level, it can be said that these relations become of prime and strategic importance. China is a very good economic partner of Serbia in Asia and one of the major pillars of Serbia's foreign policy.[4] On the other hand, Serbia is one of China's key partners in the region of Southern and Eastern Europe. China primarily sees the Southern and Eastern Europe in terms of economic integration with the European Union as a common market of high purchasing power and

[3] It seems very interesting to note that China came out with a list of priorities within the Belt and Road initiatives in February 2015. These priorities include building transporting infrastructure, facilitating the flow of investment and trade, simplification of customs procedures, the construction of logistics centres, financial cooperation, with the expansion of cooperation between nations through intensifying exchanges in culture, education, science, etc. In March 2015, the National Development and Reform Commission announced an important strategic document titled 'Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road'. This document outlines the framework of cooperation within the Belt and Road initiatives (NDRC, 2015a). On 22 October 2015, the same Commission adopted the Action Plan for Harmonization of Standards along the Belt and Road (2015–2017), which confirmed that the objectives of the previous adopted document ('Vision and Actions…'), will be achieved in practice (NDRC, 2015b).

[4] In actual Serbian foreign policy strategy, China occupies an important place. The strategy is designed on four pillars of foreign policy. The first pillar is the European Union whose member Serbia would like to become. The second pillar is Russia as a rising power in world politics and Serbia's historical partner. The third pillar is the United States, as a great power with whom Serbia has had fluctuating relations in the past, but whose importance and influence in international relations Serbia has accepted as a reality. The fourth important pillar of Serbia's foreign policy strategy is China as a global economic power and the traditionally good friend of Serbia in international relations. (Dimitrijević & Jokanović, 2016b, p. 328)

therefore an ideal space for the placement of its own products. In this regard, it is important to note that China supports Serbia's aspirations for full accession to the European Union, without prejudice to its vital national interests. At this point it is worth mentioning that Serbia is granted the candidate status for membership in the European Union on 1 March 2012. In these circumstances, Serbia has taken a significant step towards the European common market, what in prospects can create an opportunity for achieving real economic growth and social development. In Serbia's economic and social transformation, China could also play a decisive role, because it does not pursue geostrategic redesigning of the European area but seeks maintaining the stability of the existing order. This is best seen through the role of China in the UN Security Council, where it is committed to the preservation of the territorial integrity of Serbia, not accepting a violent change of borders and unilateral proclamation of independence of Kosovo and Metohija. On the other hand, Serbia supports the territorial integrity of China, its sovereignty and right to regulate its relations with the former separate parts of its territory (One China Policy). Cooperation between the two countries is now at the highest level since the establishment of diplomatic relations in 1955, and each day is expanded with new positive content.

Given the described position of Serbia in relation to China, it is clear that the role of Serbia in the Belt and Road initiatives are determined by many factors. As is well known, Sino-Serbian relations are characterized by the strategic partnership established in August 2009 with a joint statement of the then presidents Boris Tadić and Hu Jintao. This strategic partnership was deepened in August 2013 with the joint statement signed by the presidents Tomislav Nikolić and Xi Jinping. In view of the fact, a series of framework agreements on political and economic cooperation have been concluded. For example, the Agreement on Economic and Technical Cooperation in the field of infrastructure signed in August 2009, paved the way for many other joint projects in the field of energy sector, transportation, agriculture, telecommunications, finance and cultural exchange. The importance of these projects and their profitability can only be understood in the context of the implementation of the Chinese development strategy of the New Silk Road, which includes objectives of the previously formulated Go Global strategy, with which China has encouraged its companies to exploit the world markets. Also, only in this context it would be possible to understand why China promotes its own economic growth through northern and southern trade routes that meet the Chinese demand for better regional cooperation, trade diversifications, investing in transportation, and in mining and energy sectors (Petrović-Piroćanac, 2014, pp. 86–98). Hence, Serbia's position towards China's development strategy of the New Silk Road depends on the understanding of global processes in the world and geo-economic interests of China that are channelled through the 16+1 mechanism, which represents a political platform for cooperation between China and the countries of Central and Eastern Europe (CEEC).[5] This cooperation mechanism should be in the function of the objectives of the Belt and Road initiatives (Long, 2015; *China Daily*, 2014). In relation to Serbia, this mechanism can also serve as a catalyst for the establishment of strategic cooperation with China in various productive spheres (Dimitrijević & Jokanović, 2016b, p. 325). In this regard, for the purposes of this study, the author will focus on the effects of the Serbian–Chinese economic relations in the last decade.

3. Economic relations between Serbia and China

Economic relations between Serbia and China in the last decade have been characterized by mutual asymmetry in all economic parameters. The main cause of this situation is a huge difference in economic power, and then the Chinese global economic strategy that emphasizes the constant expansion of exports of domestic products and imports of energy and mineral resources for sustaining economic growth, with financial support from the state and state banks to those companies that operate in abroad. Hence, the economic cooperation between Serbia and China, in its scope, value and structure, unfortunately, has been a small part of the economic exchanges with the world of both countries (Babić, 2016, pp. 62–63).

According to the data of the National Bank of Serbia, in the period from 2005 to 2013, the total net monetary inflows from China amounted to 20 million euros (National Bank of Serbia, 2015). According to the official data of the Serbian Statistical Office, in the total commodity exchange, China was in the fifth place (after Italy, Germany, Russia and Bosnia and Herzegovina), while in terms of imports, China occupied the fourth place (after Italy, Germany and Russia). Serbia's exports to China in 2014 amounted to 14.1 million dollars, while in 2015 they amounted to 20.2 million dollars (accounting for only 0.1% and 0.2% of the total Serbian export). On the other hand, Serbia has imported

[5] The 16 countries of Central and Eastern Europe, which are involved in the Chinese initiatives represent a heterogeneous group. There are 11 EU members (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia) and 5 countries from the western Balkans region which are potential candidates for EU membership (Albania, Bosnia and Herzegovina, Macedonia, Montenegro, and Serbia).

goods from China in 2014 in the amount of 1,561 million dollars, while in 2015, it imported goods worth of 1,540.2 million dollars (accounting for 7.6% and 8.5% of the total import of Serbia in those years) (Serbian Statistical Office, 2015). According to official indicators of the Serbian Chamber of Commerce, in the first four months of 2016, there was an increase of bilateral trade by 2.9% compared to the same period last year. Exports recorded an increase of 22%, while imports grew by 2.7%. From January to November 2016, the value of imports from China in Serbia amounts to circa 1,480 million dollars (Chamber of Commerce and Industry of Serbia, 2016). Despite this asymmetry arising from real economic dominance of China, the two countries have a clear will to improve their economic and trade relations. This is best reflected through the Chinese investments in Serbia's transport infrastructure, energy and ICT sectors.

In this sense, in 2010 China and Serbia concluded an agreement on the construction of the bridge over the Danube River in Belgrade. The bridge on the Danube River was built by the Chinese state company China Road and Bridge Corporation (CRBC), a subsidiary company of China Communications Construction Company (CCCC). The bridge has a total length of 1,507 meters. With access roads the length is 21.6 km. It was originally planned that the value of the project amounts to 260 million dollars. However, during the construction of the bridge that amount was exceeded (in September 2014 annex to the agreement was signed, with a predicted increase in the value of the project to an additional 70 million dollars for expropriation and 32 million dollars for compensation of contractors and subcontractors). The project is financed from the loan of Chinese Exim Bank (85%) and from the funds of Serbia and the City of Belgrade (15%). The bridge which was named after the great Serbian scientist Mihajlo Pupin, meanwhile, was built and opened in the presence of the highest state officials of both countries in December 2014 during the China–CEEC 16+1 Summit, in Belgrade. This investment project follows the plan of building a port on the Danube upstream from the Mihajlo Pupin bridge and a road-railway bridge over the Danube at Vinča.

A particularly significant investment in transport infrastructure is the construction of High-Speed Railway (HSR) from Belgrade to Budapest which should be operationalized by the abovementioned state-owned company China Communications Construction Company (CCCC) in consortium with the China Railway International company. The total length of the railways is 350 km, of which the length on the Serbian side is 184 km and on the Hungarian side—166 km. In addition to the existing track, the plan envisages the construction of another, mixed type one for passenger and cargo transport.

The project was first endorsed in November 2013 in Bucharest, following the meeting of prime ministers of Serbia, China and Hungary (Ivica Dačić, Li Keqiang and Victor Orban) on the sidelines of the China–CEEC Summit. A year later, in December 2014, a memorandum of understanding (MoU) on cooperation in the project of the Hungarian-Serbian railway was signed by Serbia, Hungary and China, on the sidelines of the third China–CEEC Summit in Belgrade in the presence of prime ministers of Serbia Aleksandar Vučić, of China Li Keqiang, of Hungary Victor Orban and of Macedonia Nicola Gruevski. On this occasion, the Framework Agreement on Joint Cooperation in Facilitating the Customs Cooperation between Serbia, China, Hungary and Macedonia was also signed, and the four parties undertook to intensify customs cooperation and to simplify customs procedures. The prime ministers of the four countries unanimously agreed to jointly work on building the Land-Sea Express Passage linking China and Europe (Zeldin, 2015). All this should lead to setting up a unified rail transport and customs system that would connect the port of Piraeus, through Macedonia with Serbia and Hungary and the rest of Europe, transporting goods from China to Central Europe and vice versa. Premier Li Keqiang said at the time that the "railway project will contribute not only to developing and connecting countries in the region, but also to further strengthening cooperation between China and the European Union" (*Xinhua*, 2014).[6] On 24 November 2015, when Prime Minister Aleksandar Vučić attended the fourth Summit of China and 16 countries of Central and Eastern Europe in Suzhou, the Framework Agreement on the project was definitely signed. The project should be financed by China's Exim Bank. However, the pace of project implementation has slowed down due to the evaluation of the project (from Belgrade to Budapest) and then because of certain conditionality of the European Union in relation to the railway construction project through Hungary. Preliminary estimates released to the public say that the value of the project could be amounted from 1.5 to circa 2.5 billion euros. The total value of shares through Serbia was estimated to circa 400 million euros.[7] After

6 Li Keqiang also stated that "China's cooperation with the 16 CEECs will not result in fragmenting the European Union," and that "China–CEEC cooperation is undoubtedly part and parcel of China–Europe cooperation". Li also expressed his hope that "the 16+1 grouping's development goals will be aligned with the China–EU 2020 Strategic Agenda for Cooperation" (Pavlićević, 2014, EurActiv, 2014).

7 In the previous period, the Serbian government has been actively working on keeping the cost of the Serbian section of Belgrade–Budapest railway down, even below 400 million euros. This represents a significant reduction from the originally announced budget of over 850 million euros. Instead of making a new loan arrangement with China, Serbia is interested in financing the project through its own budgetary means or with the help of a previously agreed loan with Russia (Pavlićević, 2015a).

the trilateral meeting of the representatives of China, Hungary and Serbia, held in Belgrade in the first half of September 2016, the parties agreed that the signing of a commercial contract on the project of modernization and reconstruction of the Belgrade–Budapest railway should be performed at the Fifth Summit of the 16+1 mechanism in Riga, in November 2016. Finally, at the Fifth Summit in Riga, the Serbian company Serbian Railways together with the Representative of the Government of Serbia, signed a commercial contract for the construction of the first section of speed railway Belgrade–Budapest (of the length of 34.5 km from Belgrade to Stara Pazova) with a consortium of Chinese companies—China Railway International and China Communications Construction Company—in the amount of circa 319 million euros. Serbia has signed a memorandum of understanding with China's Exim Bank which envisages lending to the construction of that section of high-speed railway through Serbia. (*Politika*, 2016, p. 5)

On the basis of the data presented, it is essential to understand that the construction of the Belgrade–Budapest railway is part of China's development strategy of the New Silk Road, which aims to connect the port of Piraeus with the Central and Western Europe through Macedonia, Serbia and Hungary. The railway project will serve as an important impetus for the economic development of Serbia, Hungary and other countries in the region. The importance of this project for Serbia is also echoed by Prime Minister Aleksandar Vučić's remarks that "the Belgrade-Budapest railway would contribute to the realization of the transport networks, as well as to the movement of people and goods, which would hitherto encourage the creation of logistics routes and distribution centres, and long-term access to new markets."[8]

At the Fourth China–CEEC Summit in Suzhou, in November 2015, Serbia became a leader among CEECs in implementing joint infrastructure and energy projects with China. In Suzhou, China and CEECs supported Serbia's efforts to establish a China–CEEC centre for transport infrastructure and cooperation in Belgrade (Tianping, 2015). Bearing in mind Serbia's geographical location, traffic and energy connections with the region and beyond, the heads of government of China and CEECs concluded that

[8] Interestingly, Serbia and the countries in the region have not given up on the project Morava, which is also considered a possible direction in the framework of implementation of the strategy of the New Silk Road. Namely, on the basis of the protocol signed in January 2013, China Gezhouba Group Corporation (CGGC), has prepared a feasibility study for the construction of part of the channel Danube–Morava–Vardar through Serbia. The study included the project Channel Morava, whose value is estimated at 4.5 billion euros. As a potential contractor in 2016, the Chinese company Bonn Project is mentioned.

Serbia could be an important link along the Silk Road. Therefore, the parties gave support for the construction of industrial parks along the Danube. In addition, in the field of Serbian transport infrastructure, China also supported investment in two sections of Corridor 11 (highway E-763 Belgrade–South Adriatic): Obrenovac–Ub and Lajkovac–Ljig, in total length of 50.23 km. The construction of this highway section was taken over by the China Shandong International Economic & Technical Cooperation Group (CSI). Currently, the Chinese company is working on the construction of the remaining part of the road, with completion due by the end of July 2017. The total value of the project is 337.74 million dollars. The project is financed from the loan of China's Exim Bank (in the amount of 301 million dollars) and from the budget of Serbia (32.74 million dollars). The construction of the highway section from Surčin to Obrenovac on the section of Corridor 11 (E763), a total length of 17.6 km, including the bridge over the Sava River was taken over by the China Communication Construction Company (CCCC). According to the construction plan, the works should start in 2017. The value of the project amounts to 233.69 million dollars. The participation of the Chinese side in the project is 51%, and of Serbian companies—49%. The project will be financed from the loan of China's Exim Bank.

The Chinese state company Sinohydro Corporation signed with the Serbian side a memorandum of understanding which envisages participation in the construction of the bypass around Belgrade, in consortium with the Azerbaijani company AZVIRT. Implementation of the project foresees banded straight lines which connect Serbia with Hungary, Croatia, Montenegro and Macedonia. The bypass should be the total of 46 km in length. The contract for the financing of the project is not yet completed.

At the Third Summit between China and the CEEC, held in Belgrade, China and Serbia signed an agreement on the establishment of air traffic between the two countries. The agreement provides flights between Belgrade, Beijing and Shanghai. As envisaged, investing in air transport should be carried out by the companies Air Serbia and Air China.[9]

All the above mentioned investments follow China's investments in Serbia's energy sector. The first investment relates to the revitalization of the Kostolac B Power Plant with a value of million dollars. This project is funded by China on the basis of state-to-state loan under preferential conditions. It is important

[9] In March 2016, also the Aviation Industry Corporation of China (AVIC) has expressed interest in investing in the Belgrade Nikola Tesla Airport and smaller airports in Serbia.

to note that China's Exim Bank had approved Serbia's new loan of 608.26 million dollars to build a new thermal block Kostolac B3 of 350 MW and expand the pit mine Drmno from 9 million tons to 12 million tons per year (Pavlićević, 2015b, p. 11). The loan was approved with repayment period of 20 years, a grace period of 7 years. The total value of the second phase of the revitalization of the Kostolac Power Plant is 715.6 million euros. Additional funding, if necessary, will be provided to Serbia and its public company Electric Power Industry of Serbia (EPS). The new thermal bloc will be built in 58 months and it is expected that the work will be completed by the end of 2019. The revitalization and construction of the Kostolac thermal power plant was taken over by the China National Machinery and Equipment Import & Export Corporation (CMEC).

In addition to these investments, Chinese companies China Environmental Energy Holdings (CEE) and the Shenzhen Energy Group (SEC), in consortium with the Serbian public company Electric Power Industry of Serbia (EPS) participate in the construction of Block 3 of the Nikola Tesla B Thermal Power Plant in Obrenovac and the pit mine Radljevo. The projected installed capacity of the new unit is 744 MW. The total project cost is estimated at over 2 billion euros. According to information issued for the public, the new power plant is expected to become an independent producer of electric power, a majority Chinese-owned venture. The dynamics of the implementation of the project is uncertain due to the floods that hit Obrenovac and its surroundings in 2014.

In the field of renewable energy, it is important to note that Serbia and China have made sufficient progress. Thus, in July 2016, the Silk Road Fund, China Gezhouba Group (CGGC) and China Environmental Energy Holdings signed with the Serbian side a memorandum of understanding and joint investment in renewable energy projects in Serbia. Also, the Chinese company Goldwin undertook an obligation to supply Serbia with wind turbines, while China Machinery Engineering Company signed a memorandum of understanding which provides financing and construction of a power plant that will generate electricity from waste.

In addition to these investments, China has invested in Serbian ICT sector. These investments contribute to accelerated economic and technological development of Serbia and are very important for Serbia's inclusion in the modern economy. An illustrative example is the investment in Serbian-integrated telecommunications system for which the Chinese company Huawei Technologies and Serbian Railways company have signed a memorandum of understanding in 2011. This MoU was followed by agreements on technological cooperation in 2012, and in 2013. The estimated value of the project amounts to circa 200 million euros. The first phase of modernization should be completed by 2018, and the total value of the works is estimated at 78 million euros. The planned sections of railway lines were Corridors 10 and 11, Pančevo–Vršac and Požega–Kraljevo–Lapovo. Another significant example is investment in the Serbian company Telekom, agreed in July 2016. The agreement that was signed with Huawei Technologies provides the procurement of equipment and materials, construction and provision of services for the implementation of the ALL IP transformation. The investment is based on a preferential loan from a Chinese bank, amounting to 150 million euros.

Strategically, China's probably the most important investment in Serbia is investment in the Serbian company Iron Works Ltd. in Smederevo. This investment speaks in favour of the overall growth of Chinese industrial investments in Serbia (Yang & Zhang, 2016). The importance of this investment of 46 million euros is expressed through the reduction of the deficit of Serbian foreign trade balance with China, as well as the increase in GDP for 1%. Also, this investment affects employment growth and living standards. The investment is including an additional investment of at least 300 million euros, increases industrial activity and capacity of the Serbian economy (*Politika*, 2016, p. 5). This way, further incentives for Chinese investments in Serbia would represent mutual benefit because they promote mutual economic cooperation, raise the level of political relations, and improve the cultural, scientific and technological exchange and cooperation, and thus create the preconditions for the realization of long-term development strategy of the New Silk Road as a pledge for a common future.

4. Concluding remarks regarding Chinese investments in Serbia

Chinese investments in Serbia represent a huge opportunity for development as well as good evidence of the successful conduct of foreign policy of the two countries which promote economic cooperation not only at the interregional but also at the global level, contributing to the harmonization of relations between East and West. In this context, the mechanism of multilateral cooperation 16+1 represents a significant political tool with which it is possible to achieve the development of mutual cooperation between China and the countries of Central and Eastern Europe, as well as achieve a comprehensive strategic partnership between China and the European Union.[10] As an active participant in the 16+1 cooperation mechanism, Serbia could also be a good partner in realization of the Chinese development strategy of the New Silk Road. First, because the relations between the two countries are imbued with mutual understanding and trust, and second, China and Serbia are sufficiently open to promote various forms of economic cooperation (Janković, 2016, p. 16). This is best reflected in the presence of Chinese investments in Serbia that contribute to improving industrial capacity and living standards. However, in this regard, there are certain doubts because the participation of Chinese investments in the Serbian economy have remained modest (Jackoby, 2015). Also, their importance for accelerated economic growth is limited to certain industries such as transport infrastructure, energy and ICT sectors. Although there is a tendency of growth and expansion in other industries, these investments are criticized for being exclusively based on state-to-state loans by providing state guarantees, which in the long run brings into question their feasibility and financial profitability (Pavličević, 2015a). Of course, there are some general weaknesses that are not related directly to Chinese investments since they

[10] At the Fourth Meeting of CEEC and China, held on 24 November 2015 in Suzhou (China), the Prime Minister of China Li Keqiang said: "China supports the European integration process, as well as a united, stable and prosperous Europe that plays a greater role in the international community… China's cooperation with the 16 CEECs will not result in fragmenting the European Union. Much to the contrary, it will help deepen cooperation between China and the European Union and narrow the development gap between the eastern and western parts of the European Union… China–CEEC cooperation is undoubtedly part and parcel of China–Europe cooperation, and the two could naturally go in parallel and be mutually reinforcing." (Pavlićević, 2015b, p. 12). According to the joint statement made during President Xi's trip to the EU headquarters, China and the EU decided to develop synergies between China's Silk Road Economic Belt initiative and EU policies and jointly to explore common initiatives along these lines (Ministry of Foreign Affairs of the PRC, 2014).

stem from the macroeconomic indicators of Serbian economy that prevent their greater financial efficiency (for example, inadequate economic structure, insufficient use of production capacities, outdated technology, inflexible labour market, limited domestic consumption, poor liquidity, lack of transparency of institutions and procedures, administrative barriers, corruption, etc.) (Petrović & Mirković, 2011, p. 258).

In this respect, China's efficient and profitable investment activity in Serbia cannot stand any uncertainty. The basic precondition for China as a capital exporting country to be willing to invest in Serbia as a host country is security of its investments. In this regard, it is important that Serbia has adopted a new law on investments in 2015, which guarantees equal legal status of domestic and foreign investors. Regardless of the form of foreign investments (purchase of shares, stakes in already existing companies, establishment of a new company, concessions, B.O.T. arrangements, etc.), Serbian law guarantees freedom of investment, followed by the national treatment, legal certainty and the ability to transfer profits abroad. These guarantees for foreign investors were created during the multi-year business and financial reform legislation, which led to improving investment climate needed to attract foreign investments.

The analysis of the potential benefits of future Chinese investments in Serbia includes, in addition to the above questions, an examination of comparative advantages that Serbia has and that can contribute to improving the structure and volume of Chinese direct investment. A list of these indicators includes, among others, the following advantages: (1) a clear foreign policy goal—joining the EU and the World Trade Organization; (2) relative macroeconomic stability; (3) highly qualified and cheap labour; (4) regionally competitive financial risk; (5) restructured and privatized banking sector; (6) accelerated development of capital market; (7) contribution to the development of telecommunications infrastructure; (8) liberalized system of tariffs; (9) accelerated development of the private sector; (10) significant level of achieved stimulating fiscal, regulatory and financial measures; (11) adoption of a strategy for encouraging and developing Foreign Investment; (12) "more or less" harmonized legal framework for foreign investment with European and international standards; and (13) full visa liberalization.[11] A significant proximity of European markets and the soon-expected improvement of the transport infrastructure can also represent a comparative advantage for future Chinese investments in Serbia, particularly in the field of agriculture (especially meat processing), car industry

11 Serbia is the only country in the CEE region that has this status on the basis of the agreement signed with China at the Fifth Summit in Riga (Xinhua, 2016).

(in particular lorries and spare parts), telecommunication, machine, chemical and textile industries (*Večernje Novosti*, 2015; Blic, 2014).

5. Conclusion

From the abovementioned analysis which refers to the development of the economic relationship between Serbia and China, especially in the field of investments, we have come to the following conclusions.

First, the economic relations between Serbia and China in the last decade have been characterized by mutual asymmetry in all economic parameters. The main reason for this situation is a huge difference in economic strength, and China's global economic strategy which emphasizes the continuous expansion of Chinese exports and imports on the world markets. Second, the main determinant of Chinese foreign investments in Serbia in this respect follows the "less or more" identical model presented in other countries of Central and Eastern Europe. Chinese foreign investments, in practice, take place within the engagement of Chinese state-owned companies and state banks, with a less participation of local companies in investment operations. These investments are generally secured by state guarantees (or guarantees of the central banks of host states). This model thus evokes a certain suspicion especially in the case of countries with a strong balance of payments deficit and high external indebtedness. Third, if Serbia aspires to increase its influence and importance in international relations on the basis of economic cooperation with China, its business with China must be based on improving industrial capacity through various types of investments in different industrial areas, which could lead to overall economic growth (Pavlićević, 2015b). In this sense, Serbia should be included in international production by means of global value chains that are derived not only from the ownership forms of foreign investment, but also from non-equity investments (Kozomara, 2014, p. 109). Serbian companies, in this way, could participate proportionally in exports through global value chains whose holders are Chinese companies, which would in perspective lead to economic growth and development of economic relations. Given that macroeconomic imbalance in Serbia affects the dynamics and structure of investment inflows, especially greenfield investments, the branch structure of Serbian exports will tend to be transformed in accordance with the structure of accumulated foreign direct investments. Therefore, encouraging new Chinese greenfield investment (including takeovers and acquisitions) can contribute to the gradual re-industrialization of the Serbian real economy and thus, to the promotion of win-win cooperation, which, as a joint pledge, could lead to faster and more effective embodiments of the New Silk Road development strategy.

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Current and Potential Chinese Foreign Direct Investment in the Slovak Republic[1]

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Abstract: *This article presents an overview of current and potential investment from China into the Slovak Republic within the broader CEEC region cooperation based on the 16+1 platform. Based on a business study on the automotive industry in the CEEC region, and particularly Slovakia as one of the industrial sectors for possible Chinese investment with immense potential, the article aims to identify the main advantages and disadvantages of the region as a foreign direct investment destination. The article also analyses the impact of FDI inflows on the Slovak economy. We come to the conclusion that the recent FDI inflow from China to Slovakia has*

1 The article is part of the VEGA project No. 1/0267/15 titled ‘Chinese investments and the potential they constitute for national economies’

been statistically insignificant, which may, however, change in case the envisaged Chinese investment into the steel industry in Slovakia will be realised. With respect thereto, the article also points at the need to set out a new revised framework for the international legal protection of Chinese investment in the EU. It has been established that further research is required to assess the impact of Chinese FDI on the Slovak economy.

Keywords: *16+1 cooperation, automotive industry, CEEC region, China, FDI, investment, investment protection*

1. Introduction

Cooperation between China and Central and Eastern European countries (CEEC) within the 16+1 platform started in 2012 as Chinese initiative aimed at activating and fostering cooperation between China, 11 EU Member States and 5 Balkan states. Areas of cooperation include trade, investment, transport, science, technology, finance, agriculture, forestry, education, culture, tourism, health, and people-to-people contacts. China has defined three potential priority areas of economic cooperation, including infrastructure, high technologies, and green technologies. The initiative was announced at the first 16+1 Summit held in Warsaw, Poland in 2012 entitled China's Twelve Measures for Promoting Friendly Cooperation with Central and Eastern European Countries (MFA of PRC, 2012). Of those 12 measures, one third (measures 2–5) focus on investment and trade cooperation between China and the CEEC region.

Over the last decade, mutual relations between China and the EU have significantly expanded with Chinese investments in the EU reaching 23 billion US dollars in 2015 (an eightfold increase from 3 billion US dollars in 2009) (Zeneli, 2016). Even though most of the investment flowed to Western European countries, the CEEC region also attracted Chinese attention starting the cooperation of 16+1. Even though economic performance in the CEEC region based on the GDP p.c. in PPP is lower than the EU average (Table 1), there is potential for economic growth in the region that may exceed the growth in Western European countries. Also, the region represents a total population of 120 million. Hence, both the market potential of the region and serving as the entrance to the EU market are significant.

This article focuses on the cooperation between China and Slovakia, providing an overview of the industrial sector of Slovakia, where potential areas of cooperation and possible Chinese investment inflow could be identified. The present article also provides a basic analysis of Chinese FDI in the Slovak economy.

Table 1. Economic performance of 16+1, 2015, GDP p.c., PPP, constant 2011 international (US dollars)

EU average	35,622	Croatia	20,664
Czech Republic	30,381	Romania	20,484
Slovenia	29,097	Bulgaria	17,000
Slovak Republic	28,254	Montenegro	15,254
Estonia	27,345	China	13,572
Lithuania	26,807	Serbia	13,278
Poland	25,323	Macedonia, FYR	12,732
Hungary	24,831	Albania	11,015
Latvia	23,080	Bosnia and Herzegovina	10,119

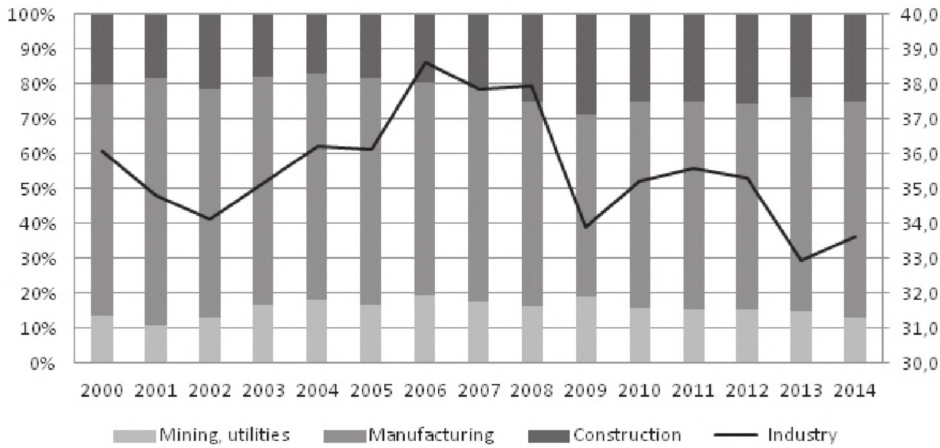
Source: World Bank, 2017

Note: In descending order based on GDP p.c.

2. Industrial sector in Slovakia

Industrial sector of the Slovak economy and its share of the GDP during the first decade of the 21st century was approximately at 33–39%. (UNCTAD, 2017). The most developed industrial sectors are electrotechnical, automotive, and engineering industries with the greatest share of their outputs being exported abroad. The development in these industrial sectors was the main force behind the rapid economic growth of the Slovak economy among the European Union countries. However, Figure 1 shows negative development in the value added of industry on GDP share after 2006 (right axis). A sharp decline was witnessed in 2008 with the global crisis widespread over the world. The share of GDP prior to the crisis and accession to the EU was approximately at 36% (with a slight decline in 2001 and 2002 to 34.8 and 34.1%, respectively). After joining the EU, the share of industrial sector has risen to 36% with a maximum share in 2006 at 38.6%. Because of the global crisis, the share has declined and in the second decade of the 21st century it averages at 34% with a possible positive outlook in the second half of the decade (UNCTAD, 2017).

Figure 1. Industrial sectors and their share of total industry value added



Source: UNCTAD Statistics 2017

Note: ISIC Rev. 3; mining and utilities divisions 10–14, 40–41; manufacturing divisions 15–37; construction division 45.

Looking at the breakdown of industrial sectors (Fig. 1, left axis) based on ISIC, Rev. 3, we note that the largest share in industrial sector belongs to manufacturing (divisions 15–37) with a total share of approximately 60%. Even though the share of manufacturing in the total industrial production has been almost the same since the beginning of the 21st century, its value-added as a share of total industry value added declined from a maximum of 24.8% in 2001 to 21.9% in 2014. The lowest share was witnessed in 2009 at 17.7%, which is clearly associated with the outbreak of the global crisis (UNCTAD, 2017).

The second important sector within the industry is construction (division 45), constituting approximately 25% of industry value added in 2014. The share of this subsector in the Slovak economy has slowly risen since 2000. This sector was the only sector (together with mining and utilities) where the value added during the crisis years increased (from 7.9% in 2007 to 9.5% in 2008 and 9.7% in 2009). Even though there was a slight decline in value added to 8.9% in 2010, the share of this subsector is around 25% on total industry value added since 2010. (UNCTAD, 2017).

The last subsector is mining and utilities (divisions 10–14 and 40–41). This subsector has the smallest share in value added of all industrial sectors (4.3% in 2014). Its share from a long-term point of view has risen and fallen since 2000 with the maximum share of 7.5% in 2006 and the lowest share of 3.7% in 2001. Overall, its share in total industrial value added is approximately 12%. The small share of this subsector of the Slovak economy is based on a fact that almost all energy needs in the Slovak economy are covered by energy sources produced abroad and imported to Slovakia. (UNCTAD, 2017)

3. Manufacturing developments

The position of manufacturing as a subsector of industry over the last 15 years has become quite dominant, even though its value added share in total industry declined during 2000–2014 from 23.9% to 21.9%. Another aspect is the share in total employment, where we notice a slight increase in the employment in the last six years. The real growth of value added between 2004 and 2012 increased by 7.5% p.a., while the growth of labor productivity was even higher at 8% p.a. As the authors mention, in real terms the manufacturing subsector (in terms of value added) gained a higher value in the Slovak economy. They also point out the significant difference between nominal and real prices for some subsectors of manufacturing, especially the production of computers, electronic and optical devices (per annum real growth of value added of 44.2%, nominal growth 14.3%) and production of electric devices (real growth 18.4%, nominal growth 6.8%). (Gabrielová & Habrman, 2014; National Bank of Slovakia, 2017)

The most important subsector which has influenced the structure of the entire manufacturing sector in the past years is automotive industry. Nominal growth of value added as a share in the manufacturing industry was 41% with a significant impact on the overall employment in the manufacturing industry. The employment in automobile industry increased by 25,400 which in turn had an impact on the decline in employment in textile industry (-35 000) and food processing (-10 000). (National Bank of Slovakia, 2017)

According to Gabrielová and Habrman (2014), looking at the changes in the manufacturing structure in the V4 countries, one can see a slight resemblance. The share of employment declines faster than the share of value added. There is also a decline in the share of light manufacturing subsectors and an increase in the subsectors that are more technologically demanding, such as automobile production, electronic devices, etc.

4. Advantages and disadvantages of the industrial sector in Slovakia—a case study for the automotive industry

Based on various studies on this topic (Gabrielová & Habrman, 2014; Šikulová, 2014; Deloitte, 2016; *Národná banka Slovenska*, 2017), we have identified below the following advantages and disadvantages of the industrial sector in Slovakia.

Advantages:

- The rising share of private enterprises
- The rising share of private enterprises with foreign ownership
- Low labor costs and skilled labor force
- Favorable tax regime

Among the disadvantages, there are:

- Low level of specialisation in pharmaceuticals, machinery and electrotechnical industries
- Lagging behind in economic performance in comparison with western EU countries
- High dependence on a small number of companies
- Orientation to commodities with low value added
- Infrastructure deficiencies
- Poor reliability of legal system
- Changes in external environment

These findings on advantages/disadvantages of the industrial sector in Slovakia have also been supported by a Deloitte study conducted in 2016 regarding the automotive industry by asking questions concerning location-related factors and their change with 80 executives of the CEEC region (8 automotive manufacturers and 72 supplier companies).

> *The importance of automotive factory locations in the European Union member states of Central Europe (CE) has steadily increased in recent years. Automotive facilities in Western Europe have been subject to closure and total employment has been reduced since 2009. However, employment opportunities have been partly re-established in CE countries, based on the fact that the previously closed factories have been relocated in the new EU member states. As a result of these changes, approximately one in three vehicles are produced within*

> *the following EU member states: the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia. Based on manufactured vehicles per capita, Slovakia is the leading producer of vehicles with 180 units per thousand inhabitants, according to the industry association European Automobile Manufacturers' Association. The Czech Republic ranks second with 108 vehicles and Germany third with 70 vehicles.* (Deloitte, 2016, p. 4)

The surveyed companies were supposed to identify three key competitive advantages and three disadvantages, and the results were the following:

> *The most beneficial factors were low labor cost; skilled labor and its availability; and the favorable tax regime. The most disadvantageous factors were the reliability of the legal system; the problematic educational system; and the inadequate traffic infrastructure and logistics.* (Deloitte, 2016, p. 6)

Other factors, both advantageous and disadvantageous, were identified. From a positive point of view, apart from the abovementioned factors, also grants and incentives were mentioned, from a negative side, the energy prices.

Based on the results, tax regime and incentives may play a crucial role in where a foreign company chooses to locate its factory. In general, taxes are lower in the CEEC region than in the rest of the EU. On the other hand, almost 50% of all respondents consider the legal system and its reliability a disadvantage and recommend measures to be taken by governments in the CEEC region to improve the situation.

It was concluded from the survey that the companies are willing to stay in the CEEC region and to make additional investments to catch up with the changes in the industrial sector, especially with Industry 4.0 which will have an impact on their businesses in the future. Surveyed companies are preparing to meet these new trends in their short and medium-term plans (Deloitte, 2016, p. 5).

A positive signal to the CEEC region is the fact that 97% of all respondents did not consider relocation of their production to another country in the next five years. None of the respondents in Slovakia was considering relocation. Only a small percentage of respondents in the Czech Republic and Hungary were considering relocation.

Another positive signal for the CEEC region are the answers concerning the production capacity increase in the next five years, where 74% of all respondents agreed on a positive outlook. According to the study, "This is clearly a very optimistic message for the CE region: the automotive sector has not yet reached its limits in terms of growth potential." (Deloitte, 2016, p. 15)

5. The impact of Chinese FDI on the Slovak economy

We used the data on Chinese FDI inflow as the main source of independent variable X. Table 2 provides data for GDP (*Y*) and FDI inflows to Slovakia from China (FDI_{China}). Since no Chinese FDI inflows to Slovak economy were present prior to 2007, only the period 2007–2015 was analysed.

Table 2. Input data for regression models (Y in euros, FDI in million euros)

Year	Y	FDI_{China}
2007	64,396,897	6,133
2008	68,022,300	1,447
2009	64,333,762	-15,212
2010	67,577,288	12,308
2011	69,482,359	24,781
2012	70,633,785	-7,315
2013	71,686,685	-10,609
2014	73,529,644	4,597
2015	76,346,627	-15,912

Source: National Bank of Slovakia.

To find the impact of Chinese investment on the Slovak economy, we used simple linear regression model in the following form:

$$Y_i = \alpha + \beta X_i + \varepsilon_i$$

where Y_i = GDP (dependent variable);
α = the y-intercept;
β = slope of the regression line;
X_i = FDI inflow to Slovakia (independent variable);
ε_i = error term.

The model is represented by following equation:

$$GDP = \alpha + \beta FDI_{China}$$

with resulting equations:

$$GDP = 69\,558\,252 - 68.293 \times FDI_{China}$$

Table 3. ANOVA results

Measure	
R^2	0.054
F-test	0.399
F-significance	0.548

Source: Authors' own calculations in MS Excel

If FDI inflows to Slovakia rise by one unit, the model predicts a decrease of the GDP by 68.293 euros. However, as presented in Table 3, ANOVA results, especially F-significance, are statistically insignificant. Based on R^2, the equation explains only 5.4% of variation in GDP, leading to the conclusion that either the number of observations is too small to fully assess the impact of Chinese FDI inflows to Slovakia or there are other more relevant factors impacting the economy of Slovakia or both. Based on R^2, we can say that currently the inflow of Chinese FDI to Slovak economy has no real impact on its overall economic performance measured by the GDP. We also note that at present, Chinese FDI do not compose a significant part of total FDI inflows to Slovakia ranging from 0.045% in 2008 to 2.33% in 2013 (based on data of National Bank of Slovakia, 2017).

However, based on the news published in the daily press, the Chinese He Steel Group, the second largest steel producer in the world, has announced plans to acquire one of the largest steel mills in the CEEC region—the Slovak U.S. Steel Košice for 1.4 billion euros. In case of this acquisition, which will be one of the largest foreign direct investments in the CEEC region, we anticipate a significant positive impact of future Chinese FDI inflows on the Slovak economy.

6. The legal protection of current and future Chinese investment in the Slovak Republic

With the prospective growth in the flow of foreign investment from the People's Republic of China into the Slovak Republic, the issue of legal protection of Chinese investment comes to the fore. The current legal framework for the protection of Chinese investment in the Slovak Republic has been—from an international law perspective—considered to be insufficient. The applicable bilateral investment treaty concluded in 1991 belongs to the 'first generation' of investment treaties concluded between China and its counterparts. It only provides for a limited scope of the now widely accepted standards of international investment protection and does not provide for an open access to international investment arbitration in case of violation of investors' rights under this investment treaty. Therefore, the international investment protection standards included in this bilateral investment treaty are currently practically unenforceable.

However, as of January 2014, the European Union has started the process of negotiating a new comprehensive Investment Treaty with the People's Republic of China which, once concluded, would also be applicable to Chinese investment to Slovakia. As of September 2016, during the 12th Round of the EU–China investment negotiations in Brussels, there has been a significant progress in negotiating particular terms of the future investment agreement, such as the core definitions of 'investment', 'covered investment', 'investor', performance requirements, standards of investment protection such as fair and equitable treatment, minimum standard of protection, expropriation as well as dispute settlement, procedural fairness in competition related procedures and standard setting. (EC DGT, 2016)

With respect to future potential dispute settlement, the negotiators have taken on the task of defining a modern comprehensive system that would avoid the infamous challenges of the current international investment arbitration system, such as lack of transparency, the risk of contradictory decisions in international investment arbitration and the resulting lack of legitimacy of the current system perceived by the public. According to the EC DG for Trade Note, the discussion on the future investment court system focused on the need to "reform the old-style system through means such as establishment of binding interpretations, an appeal mechanism or the selection procedures for the composition of panels." (EC DGT, 2016)

7. Conclusion

This article focuses on the cooperation between China and Slovakia, providing an overview of the industrial sector of Slovakia, in which potential areas of cooperation and possible Chinese investment inflow could be identified. Since the automotive industry constitutes an important part of the Slovak economy, part of the article focuses on the analysis of this industry through the case study provided by Deloitte. The subsequent part of the article analyses the impact of Chinese FDI inflows on the Slovak economy, mainly on the key economic indicator—GDP. We used the data provided by the National Bank of Slovakia for both the GDP and FDI inflows. We note that the current Chinese FDI do not compose a significant part of total FDI inflows to Slovakia. Since the first Chinese FDI inflow in 2007, it constituted a rather small share of the total FDI inflows with the highest share achieved in 2011 at a level of 0.99% (EUR 24.8 million euros compared to 2.51 billion euros) (National Bank of Slovakia 2017).

We came to the conclusion that FDI inflow from China is currently statistically insignificant. However, the sample for data analysis was not big enough since Chinese FDI inflows to Slovakia started only in 2007 (based on the data provided by the National Bank of Slovakia) with latest available data for 2015, which means only nine observations.

Even though the Chinese FDI inflow proved statistically insignificant, we believe that with possible acquisition of the U.S. Steel's steel mill in Košice by He Steel Group would turn the negative development of Chinese FDI inflow to Slovakia to a more positive trend. This may be followed by other potential investments, with especially favorable conditions in the automotive sector, which, according to the Deloitte study from 2016, still has a great growth potential not only in Slovakia but also in other CEE region countries. Steel industry also serves as a subcontractor for the automotive industry, which may have significant synergic effects and positive effects not only on the GDP growth in Slovakia and other CEE region countries, but also on the net profits of possible Chinese FDI inflows to these sectors of the economy.

In the last section of this article, we outlined the shortcomings of the currently applicable international legal protection of Chinese investment in the Slovak Republic. However, with the prospective EU-wide Investment Treaty with the People's Republic of China which has been under negotiations since 2014, many of the current challenges of the system are addressed and may be resolved once concluded.

We conclude that further research will be required to fully assess the complex nature and impact of Chinese FDI on the Slovak economy.

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Cooperation Formats of China and Europe: Synergies and Divergences

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Abstract: *This contribution articulates the synergies and divergences of the various formats of cooperation between China and the European countries. The EU and China have a strong interest in each other's flagship initiatives, namely the Investment Plan for Europe, and the One Belt, One Road Initiative (Silk Road Economic Belt and 21st-Century Maritime Silk Road). The authors argue that there are certain synergies between these initiatives. Furthermore, the new initiative EU–China Connectivity Platform is aimed to explore these synergies. The authors explore the recent developments in the EU–China investments, trade cooperation and the challenges of the ever-growing CEEC–China partnership in different formats, including the new platform of 16+1. The authors examine these implications in relation to the need to expand and adapt the content and approach of the EU–China Bilateral Investment agreement. The*

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article concludes that the CEEC–China relation does not go against the EU; moreover, neither the CEE countries nor China have any motivation to try to weaken the EU.

Keywords: *Bilateral investment agreement, CEEC economic integration, EU, trade and investment*

1. Introduction

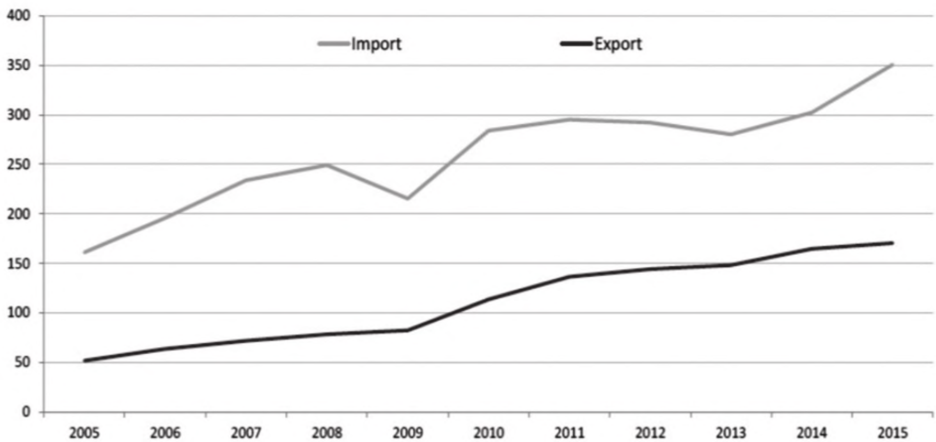
Historically, EU–China relations have focused to a large extent on trade in goods, and recently trade in services has also been growing rapidly. Trade in services is a relatively new development as compared with trade in goods. Contemporary EU–China initiatives and new cooperation formats have taken place in a difficult geo-economic situation and climate shaped by the impact of the economic crisis, Brexit and the US elections will have further repercussions to the EU–China relations also in the light of uncertainties regarding the Trans-Pacific Partnership Agreement (TPP) and the Transatlantic Trade and Investment Partnership (TTIP). This could subsequently lead to a further increase of China's role in the global arena—including trade and investments.

The field of investments is still seen as holding a vast untapped potential for European and Chinese economies. The article explores the recent developments in the EU–China investments and trade cooperation and the challenges of the ever-growing CEEC–China partnership in different formats, including the new platform of 16+1. While this new platform is still a 'work in progress', it has attracted increasing attention for supposedly affecting the united stance of the EU in the conduct of its foreign policy. In this article the rationale of each of the three sides—China, the EU and, more specifically, Central and Eastern European countries (CEEC)—will be analysed. It is argued that there is nothing substantive in this relation which would go against the EU; moreover, neither the CEE countries nor China have any motivation to try to weaken the EU. The article also articulates the synergies and divergences of the various formats of cooperation between China and the European countries.

2. EU–China trade and investments

The EU and China are two of the biggest traders in the world. China is now the EU's second trading partner behind the United States, and the EU is China's main trading partner. EU–China trade has increased dramatically in recent years; for most trade items they are increasingly competitive (Fig. 1).

Figure 1. Development of EU exports and imports of goods with China, 2005–2015 (billion euros)



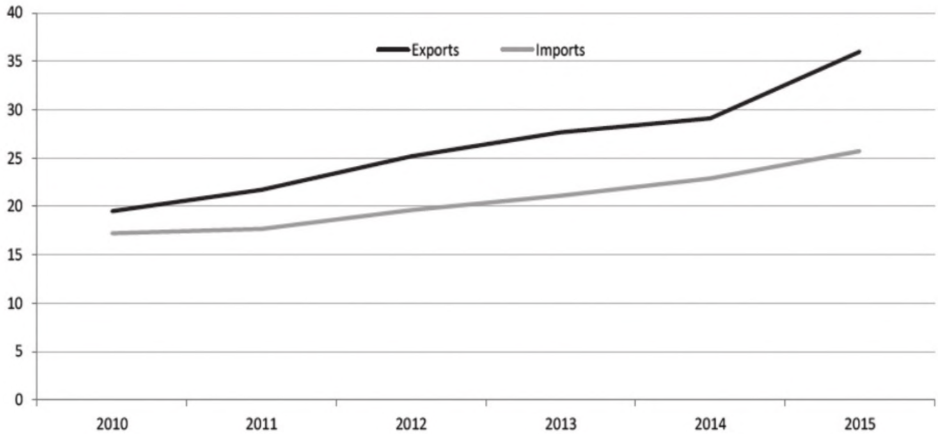
Source: Eurostat, 2016

China and Europe now trade well over 1 billion euros a day (EC DG Trade, 2016). The EU imports from China are dominated by industrial and consumer goods: machinery and equipment, footwear and clothing, furniture, and toys. EU exports to China are concentrated on machinery and equipment, motor vehicles, aircraft, and chemicals. According to the DG Trade of the European Commission (EC, 2016), the year 2015 has been marked by record trade deficit in goods worth of 180 billion euros, but record surplus in services (Fig. 2).

The EU is committed to widen trading relations with China. However, the EU wants to ensure that China trades fairly, respects intellectual property rights and meets its WTO obligations.

The 2008 financial crisis in Europe, and the subsequent (and still ongoing) debt crisis which hit the continent in 2010, has caused European investors to hold on tightly to their wallets. Europe today does not have a cash problem; it has a

Figure 2. Development of EU exports and imports of services with China, 2010–2015 (billion euros)



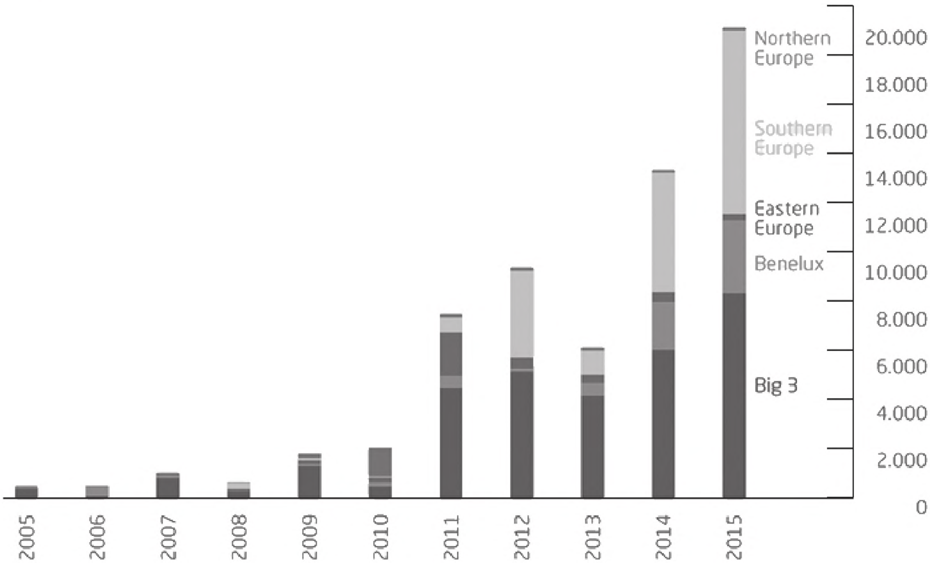
Source: Eurostat, 2016

liquidity problem. Businesses lack the confidence to spend the money they have. On the other side of the world, China is flush with cash from its economic boom. Chinese investors have stepped into the European investment void, buying properties, industries and financial assets (Fig. 3). China's outbound foreign direct investment (OFDI) has grown exponentially in recent years and hit a new record high of 20 billion euros in 2015, illustrating China's potential to become an important source of capital for Europe.

The 'Big 3'includes France, Germany and the UK; 'Benelux' includes Belgium, Netherlands and Luxembourg; 'Eastern Europe' includes Austria, Bulgaria, Czech Republic, Hungary, Poland, Romania and Slovakia; 'Southern Europe' includes Croatia, Cyprus, Greece, Italy, Malta, Portugal, Slovenia and Spain; 'Northern Europe' includes Estonia, Denmark, Finland, Ireland, Latvia and Sweden.

Investment flows show vast untapped potential, especially when taking into account the size of the respective economies. China accounts for just 2–3% of overall European investments abroad, whereas Chinese investments in Europe are rising, but from an even lower base while investments from the EU in China amount to a mere 5% of European investments abroad and only a fraction of the overall trade volume. In turn, foreign direct investment (FDI) from China represents less than 3% of the total FDI inflow into the EU (Hanemann & Huotari, 2016). At the same time, the competition among EU states for Chinese

Figure 3. Chinese OFDI in the EU-28 by country group 2000–2015 (million euros)



Source: Rhodium Group, 2016

capital has intensified, which weakens European leverage vis-à-vis China on important strategic questions. Moreover, investment patterns in 2015 further aggravate the existing economic concerns related to Chinese investment, most importantly the lack of equal market access for European companies in China and potential market distortions through state-owned and state-supported enterprises. Addressing those concerns now is critical as China expects to deploy an additional 1 trillion US dollars in OFDI in the coming five years in Europe and globally (Mission of China to the EU, 2016). Chinese investors have broadly followed the footsteps of other foreign investors in Europe by putting most of their investments in the wealthiest and largest European economies. The 'Big Three' (Germany, the UK, and France) have received a relatively constant figure of 4–8 billion euros over the last five years and they continued to be major targets in 2015. The big story of the past two years, however, is the sharp increase of Chinese OFDI in other parts of Europe. In 2015, Southern European economies accounted for almost half of all Chinese EU investment for the first time. High-profile 'flagship deals' (ChemChina's acquisition of Pirelli, Wanda's investment in Atletico Madrid, and Haitong's acquisition of Banco Espirito Santo's investment banking business) have put China in the role of a significant investor in those economies, amid otherwise sluggish FDI inflows. Investments in the Benelux countries also increased markedly in the past two years and pending projects could further boost Chinese presence in Eastern Europe if they materialise (Mission of China to the EU, 2016). The broader geographic dispersion of Chinese OFDI across Europe has increased competition between EU states for Chinese investment (Fig. 4).

Figure 4. Chinese FDI in the EU-28 in 2000–2015 (million euros)

Source: Rhodium Group, 2016

In 2015, virtually every EU Member State (MS) has sought high-level exchanges with China to strengthen bilateral investment and China is increasingly able to use the promise of capital as a carrot for other foreign policy goals. Greater capital flows, for example, remain the core driver of the rapidly evolving '16+1' relationship between China and Central and Eastern European economies. Another example is the UK, where a flurry of high-profile investments has contributed to a visible shift in the UK's China policy. This race for Chinese investment is also contributing to a division between European economies over important economic policy decisions, most recently whether the EU should grant China Market Economy Status or if the EU should enter negotiations over a potential free trade agreement with China.

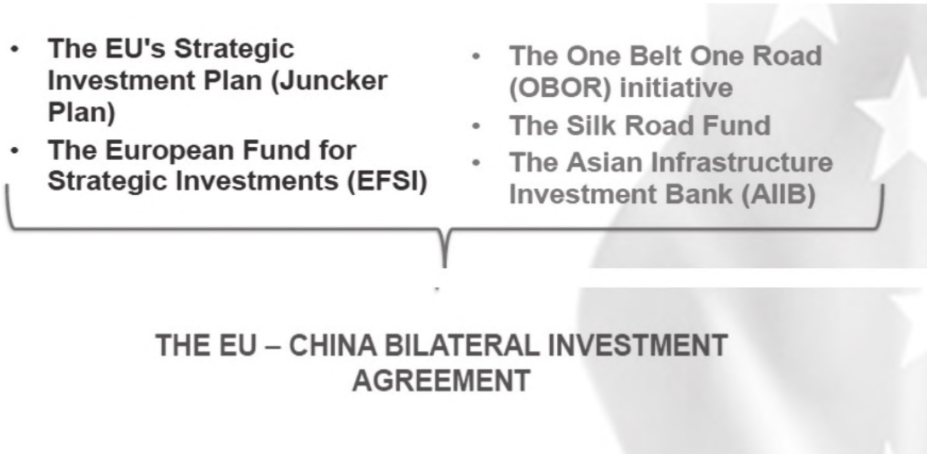
In addition to the anticipated economic gains from increased investments within various formats, European policymakers and businesses alike have placed high hopes in the conclusion of the bilateral investment agreement (BIA). In January 2016, representatives of the European Commission and the Chinese Ministry of Commerce met in Beijing for the ninth round of negotiations over the BIA between the EU and China. Negotiations over the BIA were initiated after the eurozone crisis erupted in 2008. The need for liquidity in European countries served as an impetus to enhance the possibilities of acquiring investments from outside Europe, while China pursues secure and predictable environments for its investments. The EU–China BIA is one of the priorities of the EU's new trade and investment strategy 'Trade for All' (Ewert, 2016), as a means to deepen relations with China. According to optimistic estimates, the negotiations could be concluded in 2017.

3. Flagship initiatives to foster EU–China investment cooperation

The EU and China have a strong interest in each other's flagship initiatives, namely the Investment Plan for Europe, and the Belt and Road initiative (Silk Road Economic Belt and 21st-Century Maritime Silk Road). We argue that there are certain synergies between these initiatives (Fig. 5).

Furthermore, the new initiative EU–China Connectivity Platform is aimed to explore these synergies.

Figure 5. The EU–China cooperation: when geopolitical meets geoeconomics



Source: European Economic and Social Committee, 2016

3.1 Investment Plan for Europe

The idea behind the European Fund for Strategic Investments (EFSI) is that the public money will unlock the money from hesitant private investors in Europe and beyond. One could argue that the Chinese are more inclined to find Europe an attractive investment than are European investors. Chinese Premier Li Keqiang announced at the EU–China summit that China stands ready to dock with the EU's investment plan and make infrastructure investments (Mission of China to the EU, 2016). Specific figure on China's investment intentions has not been mentioned, although media reports have speculated that Beijing could invest between 5 and 10 billion euros in the EFSI, the EU's guarantee scheme to back risky projects in the EU. EU officials and Chinese authorities are examining what instruments could be used to channel the investment. The European Investment Bank (EIB) has set up a working group with the task to identify concrete modalities for joint EU-China cooperation on the Investment Plan for Europe. The group, which includes experts from China's Silk Road Fund, the Commission, and the EIB, will explore areas and opportunities for co-financing and participation from the Chinese side (Valero, 2016).

China's investment in the EU has sparked controversy in the past. In Greece, Chinese company COSCO was blamed for paying a fraction of European salaries and for not respecting European rights, according to the longshoreman's union (Valero, 2016). Elsewhere, Chinese labourers have been brought in to work on massive infrastructure projects, calling into question whether its involvement would create additional jobs for Europeans, as the investment plan aims to do.

The UK obtained financial support from China to construct a nuclear plant in Hinkley. In return for a 2 billion pounds loan guarantee, the UK will allow Chinese companies to build an additional nuclear plant in Bradwell, Essex.

The GMB union, which represents nuclear workers, said linking that deal to a reactor at Bradwell would be a "betrayal" of British workers. Brian Strutton, GMB National Secretary for Energy, said that "Chinese nuclear technology is unproven, and no UK government should even consider allowing it to be used in a new nuclear power station 60 miles from London" (Valero, 2016).

However, referring to Fraser Cameron, director of the EU-Asia centre in Brussels, China's contribution to the new investment fund represents a "win-win situation" for both partners (Valero, 2016). While Beijing wants to bolster its soft power in Europe, and gain European support on issues such as the reform of the IMF and the World Bank, China is also looking for large-scale projects to invest in that represent good business opportunities, in particular, high-speed trains and nuclear power plants.

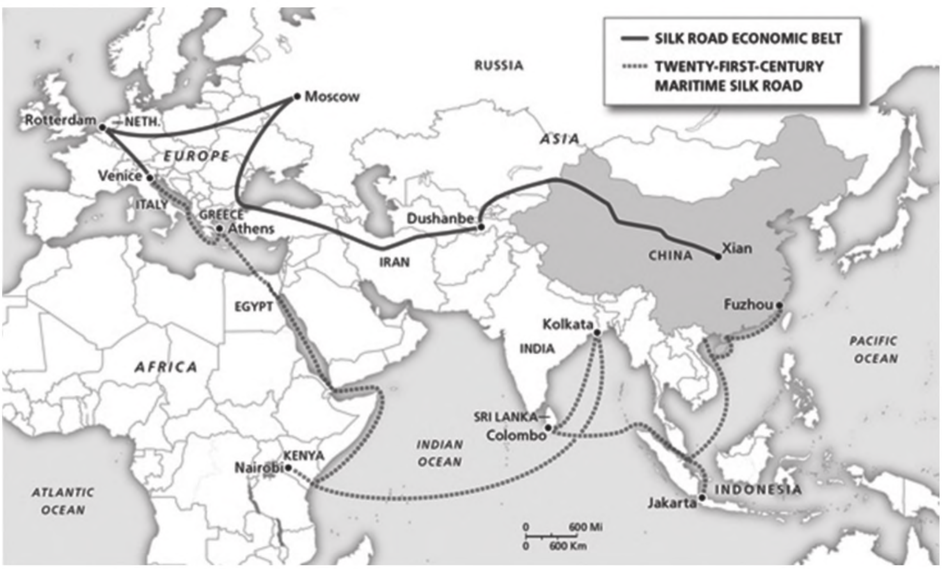
3.2 China's Belt and Road initiative

The figures speak for themselves—55% of the world's GDP, 70% of the world's population and 75% of energy resources are concentrated in the region covered by the OBOR initiative. With a planned overall financial commitment of around 1,400 billion euros, the strategic objective of this initiative is to reinforce China's role in global relations and step up its economic and trade relationships with the 65 countries also involved through transport and logistics infrastructure projects (Palmieri & Celi, 2016).

The Juncker Plan and China's Belt and Road initiative are symmetrical. This strategy, which was unveiled in 2013, is focused on connecting the countries of Eurasia and the wider world through improved infrastructure networks, investment projects and cultural exchanges. The initiative has a land and a sea component, known respectively as the Silk Road Economic Belt and the 21st-Century Maritime Silk Road. Unlike the original Silk Road, however, the new project is not predominantly about transportation infrastructure but about economic integration. It attempts to create a set of political and institutional tools with which China can start to reorganise global value chains and stamp its imprint on the rules governing the global economy.

The initiative is aimed at encouraging the countries along the Belt and Road to achieve economic policy coordination and carry out broader and more in-depth regional cooperation, and jointly create an open, inclusive and balanced regional economic cooperation architecture. In June 2015, China and Hungary signed a memorandum of understanding on further cooperation under the framework of the Belt and Road initiative. It is the first initiative document China has signed with a European country. China will work together with Hungary to step up the modernisation of the Budapest–Belgrade railroad, the construction of a China-Europe land-sea express line and completion of other major infrastructure projects (Gambrella, 2016). Both the Belt and Road initiative and the Juncker Plan will be primarily focused on infrastructure and cross-border connections. The plan is for 'Silk Road' infrastructure projects to extend all the way to Budapest, where they could link up with EU infrastructure projects funded by the Juncker Plan.

Figure 6. The Belt and Road Initiative map



Source: Xinhua, 2015

The interest of Chinese businesses in investing in the European market is currently intense. Last year non-financial foreign direct investment from China to the EU was almost 10 billion dollars, exceeding FDI from the EU to China for the first time (Macaes, 2016). It is not just the lack of intra-European investment that is attracting Chinese businesses. Europe's regulatory environment also makes it an attractive destination.

3.3 EU–China Connectivity Platform

The willingness of the EU and China to explore synergy between the two development strategies lead to establishing the EU–China Connectivity Platform as a vehicle to connect the Eurasian continent through a physical and digital network. The network would enable the flow of trade, investment and people-to-people contact (Turcsányi, 2014). According to the EU strategy, cooperation on digital economy should harness growth through open markets, common standards and joint research on the basis of reciprocity in areas such as 5G mobile communications and the internet of things (EC, 2015).

With the EU's know-how and mature legislation system, and China's huge market needs and fast-moving innovation on advanced technology, the EU and China are natural partners, The Connectivity Platform would provide visibility on investment opportunities along the Silk Road to interested investors and other parties, as well as to provide a level playing field for investors and relevant business on both sides. Some of these projects might be suitable for financing by EU resources (including EFSI) and/or Chinese funds (such as Silk Road Fund). The EIB would contribute to the work of the Platform so as to explore opportunities for co-financing infrastructure links between the EU and China, in the framework of EIB external mandates.

The EU wants a China that is economically more open and stable, with significantly improved market access for foreign companies. A company like Alibaba could play a key role in this process by providing the EU companies—and in particular small and medium-sized enterprises—a platform to reach Chinese undertakings and consumers. In this context, deepening cooperation on customs and trade facilitation would be appropriate to boost e-commerce between the EU and China. At the same time, the EU establishes a common minimum definition of what constitutes critical national infrastructure in the context of inward investment, to provide legal certainty and promote investment, something it has done, for example, with the countries of Eastern Partnership (Kerikmäe & Chochia, 2016).

3.4 Investment banking for infrastructure building and strategic development in Asia

The new international development bank was launched in early 2016. Although it is seen as a rival to the US-led World Bank, many countries have agreed to join the Asian Infrastructure Investment Bank (AIIB) in recognition of China's growing economic clout. So far 13 EU Member States (Austria, Denmark, Finland, France, Germany, Italy, Malta, Netherlands, Poland, Portugal, Spain, Sweden, UK) have joined the Asian Infrastructure Investment Bank, which is considerable participation, at the same time indicating that not all EU Member States have the same stance on the issue of joining the AIIB. The prospects for other EU Member States to join are not clear and depend very much on countries themselves. It seems that Beijing seeks to change the unwritten rules of global development finance. The AIIB is expected to lend 10 to 15 billion dollars a year for the first five or six years and has started its operations in the second quarter of 2016 (Palmieri & Celi, 2016). The opening of the Asian Infrastructure Investment Bank (AIIB) is part of China's vision of strategic development, which aims to achieve the "two centenary goals".

For China, the new bank is fundamental for reinforcing its international position outside the Post Bretton Woods System. The initiative is intended to support the introduction of a multipolar financial and currency system able to offer alternative solutions to the monopoly of the dollar.

Unlike other, similar initiatives, such as the New Development Bank (NDB), which was set up by the BRICS, China has asked other countries to be founding members of the AIIB without any prerequisites. While for Asian countries this provides an opportunity to take actively part in the decision-making process on investments which will reduce their infrastructure deficit, for European countries joining the AIIB is seen as an opportunity to tap into the major infrastructure market which will be developing in Asia in the coming years by winning tenders and subcontracting contracts for their own companies.

4. Framework 16+1: developments and prospects

4.1 New opportunity

Despite the large volume of trade, mutual direct investment is still relatively low, according to the European Community with just over 2% of EU FDI in China (EC, 2016).

For years, European companies sought to benefit from cheap labour by building factories in China, but today that trend is reversing. Chinese investors are now eyeing Eastern Europe and the Mediterranean, where the eurozone crisis has pushed labour costs down and created hunger for foreign investment.

The CEE EU countries are not at the forefront of EU relations with third countries. Since the fall of the communist regimes their foreign policies have been almost predominantly oriented towards the EU. Now these countries are interested in developing relations with China in the CEEC–China 16+1 cooperation format, which raises issues in relation to the EU common foreign trade policy. CEEC–China 16+1 cooperation format is driven by trade promotion and investment, thus serving as a basis for enhancing the bilateral cooperation between China and CEEC, which the Chinese media describe as a "golden opportunity". The format has included a wide range of activities and in such sectors as cooperation and connectivity, economic and financial issues, agriculture and forestry, science, technology and health, people-to-people contacts and cultural exchanges, cooperation at the local governmental level (LIIA, 2016).

The format, which held its first summit in 2012 in Warsaw, Poland, brought together leaders from China and 16 CEEC: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia, and Slovenia.

The situation of bilateral cooperation between China and CEEC is rather diverse with very different levels of progress and engagement achieved. But the questions remain: where there is this "golden opportunity" and whether there are any risks when it comes to the synergies between the EU–China relations and the 16+1 cooperation? Since the opening up of the 16+1 platform, relations between China and the CEEC have been increasingly attracting attention around Europe, for supposedly affecting the united position of the EU, which is against the EU good practices to develop a separate institutionalised relation with a third state. The rationale for this relatively new relationship should be seen from three perspectives—China as the initiator of the platform; the involved CEEC as the main beneficiaries; and the EU as the 'mother' unit partly encompassing the CEE region. Scholars argue (Turcsányi, 2014) that statements about a dividing line are improper and these accusations are based largely on false presumptions or potential future problems. On the other hand, the approach of the Western European countries may in fact point to the EU's internal problems. China is exploring new ways to expand its exports, looking for secure and reliable channels and hopes that building up better relations with the CEEC, most of whom are also EU MS, can help push forward its overall relations with the EU. In this context, the 16+1 format represents for China its complimentary "bridge to Europe". The CEE region is becoming a distinct link within China's new Silk Road, which will more directly connect East Asia to Europe. Logistically CEEC will play a crucial role in making sure China's Silk Road Economic Belt reaches its final destination—Western Europe.

4.2 Achievements to date

The format has made CEE important in terms of Chinese foreign policy. Since the summits in Belgrade and Riga, the role of the Balkans and Baltic states in Chinese policy towards Europe has increased. Miscellaneous meetings under the 16+1 format contributed to the intensification of political dialogue on the lower level (for example, that of ministers and local authorities) and people-to-people exchanges. Moreover, the status of Central Europe within the region and in the EU has been raised. The CEE countries showed that they are able to establish their own formula for cooperation with China, and to pursue an active policy towards non-European great powers. Another result is the rise of interest of potential investors in countries, which hosted the 16+1 summits. For example, Serbia and Romania recorded increased interest from potential investors, not only from China but also from Korea and Japan. As far as economic cooperation is concerned, discrepancies between EU and non-EU members are noticeable, especially in terms of investments and infrastructural projects. They are located mainly in the non-EU countries, which indicate the weakness of Chinese financial instruments that are not adapted to the needs of all countries. The Chinese credit line is being used, for example, in Bosnia and Herzegovina for the construction of a thermal power plant in Stanari, in Macedonia for building highways, and in Serbia for a Belgrade bypass. Credit from China-based Exim Bank is being used to build a new thermal power plant unit in Kostolac. Similar credit was also utilised to build a bridge over the Danube in Belgrade, which was officially opened in 2014 (Szczudlik, 2016). In terms of failures to date, there has been little progress with the high-speed Belgrade-to-Budapest railway, a 16+1 flagship project. Many agreements have

The Riga Summit

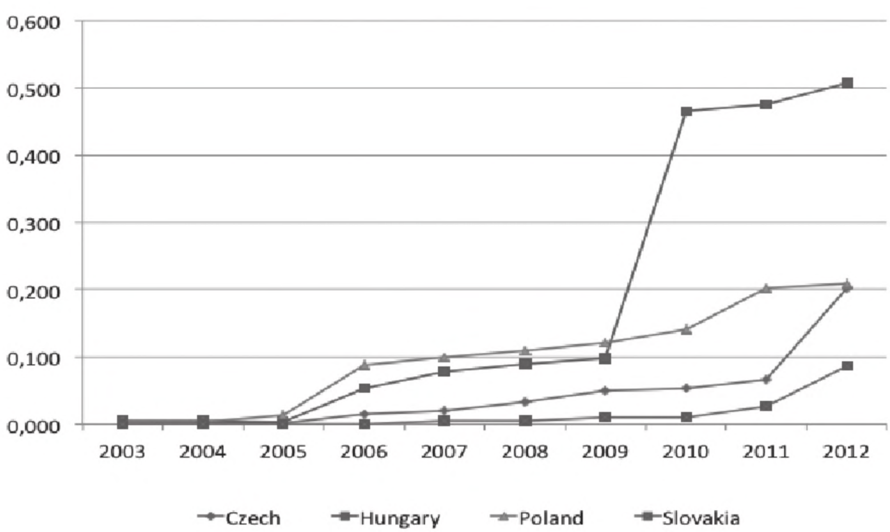
The fifth CEEC–China 16+1 Summit took place in Riga on 4–6 November 2016; although it is seen as a great achievement by Latvian hosts, there was an overall impression that it was very much Chinese-driven event. Both the Latvian PM Kučinskis and the Chinese PM Li Keqiang emphasised the importance of EU–China cooperation and complementarity of the 16+1 format. At the summit, China launched a 10 billion euro investment fund to finance projects in CEE (Ministry of Foreign Affairs of the Republic of Latvia, 2016); the fund is aiming to raise a total of 50 billion euros in project financing for sectors such as infrastructure, high-tech manufacturing and consumer goods. While targeting the CEE region, it could extend to the rest of Europe and other areas, if relevant to China–CEE cooperation. It also has certain synergy with and well compliments the Investment Plan for Europe (Nikers, 2016).

The summit focussed on the logistics and development of new freight routes, symbolically, the first rail cars loaded with containers arrived in Riga from the Chinese city of Yiwu, carrying textiles, plumbing and household goods, the train travelled more than 11,000 kilometres across Russia to Riga in 16 days (Yiwu–Zabaikalsk–Riga).

It is evident that China is becoming an increasingly important trading partner for all three of the Baltic States, as their access to and interest in the Russia market has gradually eroded. Moreover, the Baltics' exports to China have been growing. Ten years ago, in 2006, Latvian exports to China accounted for only 10 million euros, while currently they have grown to more than 100 million euros (106.75 million US dollars). Latvian food exports to China, in particular, have found new niches thanks to the certification of a number of dairy and fish manufacturers. In addition, Latvian timber products, cosmetics and electrical equipment have also been making substantial inroads in China (Simurina, 2015).

been signed but not implemented, and there are concerns that the 1.7 billion dollar line of credit extended by China may seriously increase Hungary's national debt. Furthermore, the European Commission has initiated preliminary infringement proceedings against Hungary. This is because the project assumes implementation by a consortium from Hungary and China (15% and 85%, respectively) based on an intergovernmental agreement (Szczudlik, 2016), but not through issuing tender procedures. In Riga the decision was made that the consortium will announce a tender and sign agreements with contractors. This means that the consortium itself will not be a project contractor, although the financial aspects have not changed and 85% of the project (Szczudlik, 2016) was expected to be financed with Chinese credit. Still, the level of Chinese investments is modest, while the trade deficit on the CEE side is increasing. China has not yet located manufacturing bases in Central Europe, an idea that it announced at previous summits. At the same time Chinese firms are increasingly investing in CEEC. These investments are quite a new phenomenon and still constitute a small share of China's total FDI in Europe (10%), but since 2006 we have seen a growing influx of Chinese investments into the region, which is expected to increase further in the future (Fig. 7).

Figure 7. China's OFDI stock in Visegrad Countries, 2003–2012 (billion US dollars)



Source: CEIC, 2012; MOFCON 2013

4.3 Prospects

China and the European countries will not abandon the 16+1 format—a useful political instrument. One may expect an extension of the format, for example with other countries acting as observers. This assumption may be vindicated by the fact that China has recently been promoting the 16+1 as “open”. With more countries on board in the framework of 16+1, China may highlight its rising international status and attract more allies for its own interests. At one 16+1 meeting in Ningbo, in June, Hungary openly declared support for granting China market economy status. It also supported China’s position on the South China Sea issue, just before a ruling by the Court of Arbitration, and afterwards, with Croatia, was reluctant to adopt the EU statement about this issue. The decision to hold the next 16+1 summit in Hungary might be perceived as appreciation for Viktor Orbán’s pro-Chinese policy. It is worth mentioning that the Czech Republic was also interested in hosting the next summit (Szczudlik, 2016). For China, the 16+1 remains a mechanism for gaining knowledge about the region, such as investment conditions and plans, important for the implementation of the Silk Road initiative.

The 16 countries will also use the format to indicate their own interests and strengthen bilateral relations with China. A good example is Latvia, which is greatly interested in transport in the northeastern part of Europe. Latvia sees opportunities for cooperation with China, following the deterioration of its relations with Russia after the imposition of sanctions that limited Russian trade in the ports of the Baltic States. The 16+1 format should serve as well for Poland (Szczudlik, 2016) as a complementary element for strengthening bilateral relations and the pursuit of Polish interests.

5. Concluding remarks

The analysis shows that there is high level of synergy between the EU–China and CEEC–China cooperation as both are based on the same objectives to boost trade and investment and to create jobs and growth. CEEC and China’s ever growing cooperation should rather be seen as complementary to the efforts that are taken on the EU–China level. In addition, there are no major risks that could go against the EU; moreover, neither the CEE countries nor China have any motivation to try to weaken the EU.

Chinese investments and trade cooperation and the challenges of evergrowing CEEC–China partnership in the different formats, including the new platform of 16+1, are still a new platform a 'work in progress' and have attracted increasing attention for affecting the united position of the EU in its foreign policy.

In the last decade, bilateral relations between the EU and China have become a real "strategic partnership" in the areas of trade cooperation, environmental protection, innovation, research, education and international security. In the coming years, cooperation will become even stronger and more challenging. If these challenges are to become opportunities using a win-win approach, they must be based on the "reciprocity" principle.

While in China the framing and implementation of development policies is very much centrally coordinated, the EU is definitely weak when it comes to framing common political and economic strategies; in many cases, particularly regarding economic issues, the EU MS compete instead of cooperating, leaving individual enterprises to decide on strategies on how and where to invest. This dynamic could harm the economy of the majority of MS, particularly given that these challenges cannot be tackled effectively by individual national systems.

The need to reinforce EU action on the "European dimension" of OBOR is clear from the fact that under the 16+1 mechanism (12 of the 16 are EU Member States), cooperation is already underway between China and the CEE countries. This process should be properly managed for this dynamic not to lead to tension, damaging European cohesion and relations between the EU, its MS and between the countries themselves.

The absence of a clear and coordinated EU position on the AIIB has not allowed for the planning and implementation of a common strategy, which would certainly have been useful for harnessing the EU's interests to those of the individual MS. Given the pace of change and the considerable prospects for development of AIIB, the EU should support greater coordination at Member State level, partly with a view to shaping initiatives planned and implemented using a common approach which analyses all the abovementioned initiatives holistically.

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