

# WORKING PAPER

## **Economic “highway” with three speed tracks and destinations between China and CEE**

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## **Economic “highway” with three speed tracks and destinations between China and CEE**

### **Abstract**

*The launch of the “16+1” Cooperation Framework in 2012 enhanced economic relations between China and CEE countries, which already had craved for China’s financial support to recover from the recession during 2008-2009 crisis. After six years of a high political and economic engagement, to what extent China has materialized its influence in the region? This paper compiles data from various sources and tries to update our understanding of China’s current presence and potential impacts in the CEE region through three economic interconnection channels as pronounced in the “One Road, One Belt” initiative, namely trade, investment, and infrastructure. Through the horizontal comparison with EU’s more advanced 15 members’ engagement in the region, China’s envisioned economic “highway” is currently composed of three parallel tracks, where EU-CEE tradition and China’s innovative approach interact in different ways. The influence of preexistent EU-CEE economic pattern varies among three economic pillars, with the trade being the least touched, the finance of infrastructure projects being the most conflicting and the ODI pattern being the best example of mutual impacts. From the perspective of interest stocks of China in CEE, China’s economic exchange with the most important economies in the region falls into EU framework, which suggests that the state’s potential and its economic structure are the basic reason of the strength of bilateral economic relation. However, from the perspective of interest flows, China’s importance has been significantly increased in smaller states, which, on the one hand, will generate more tangible impetus to economic growth in periphery CEE countries, thus leveling regional discrepancy; on the other hand, will challenge once EU dominated institutional arrangement. Under this context, CEE has turned out to be the strategic region where China and EU would compete and cooperate with each other according to the efficiency of their relative economic diplomacy to define the most beneficial policies that are tailored better to the interests of CEE countries.*

**Keyword:** *China, CEE, Trade, ODI, Development finance*

### **Introduction**

During the sixth summit of heads of government of Central and Eastern European (CEE) Countries and China held in Budapest in November 2017, three final CEE countries (Estonia, Lithuania and Slovenia) have signed memorandums of understanding to promote the Belt and Road Initiative (OBOR), signaling that all 16 CEE countries have agreed to align with the

initiative. However, the relationship between CEE countries and China is not always so close. Despite the common communist past, the relationship between two parties was at best lukewarm for a long time, especially during the 1990s when most of CEE countries focused their foreign policy to enhance the relationship with the European core economies. It was not after 2004 when many of them became members of the European Union (EU) that China became interested in strengthening economic (as well as political) ties with the region. China-CEE relations warmed up quickly since the 2008 economic and financial crisis, which might induce a policy adjustment among CEE countries to look eastward for alternative export market and financial resources. From Chinese side, Xi Jinping's tour as Vice-President in 2009 to Europe<sup>1</sup> signaled a tangible shift in the Chinese leadership's attitude toward CEE, making clear Chinese desire to accelerate its diversification strategy through the emerging countries in the region. Xi's visit lit the high expectations of CEE countries for the economic benefits that China might bring to the region, particularly the financial support to their infrastructural development and the opening of the Chinese market for their exports.

In 2011, China's strategy toward CEE was put forward further by grouping 16 CEE countries (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia and Slovenia) as a bloc during an economic forum organized in Budapest. A year later, the first meeting at the level of heads of government was held in Warsaw, marking the official launch of the 16+1 framework. In this meeting, Wen Jiabao, then prime minister, proposed the "Twelve Measures Strategy" for mutual engagement, which went beyond economic cooperation and extended to cultural, education, academic and political cooperation<sup>2</sup>. Thereafter, the 16+1 format was institutionalized by a special secretariat created in China's Ministry of Foreign Affairs and the annual summit between two parts for regular communication. One year after the launch of the 16+1 format, Xi Jinping, the current president of China, proposed to revive the overland and maritime silk road respectively in September and October. This proposal was later pronounced officially in 2015 as "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road". As the OBOR's currently developed or planned geographic corridors all pass through CEE countries before they reach Western Europe<sup>3</sup>, the CEE region is considered as critical for the successful implementation of OBOR. OBOR is therefore supplementary to and being implemented simultaneously with the 16+1 framework. This was confirmed by the unprecedented visits of Xi Jinping himself to Belarus in April 2015, Prague in March 2016, and Belgrade and Warsaw in June 2016 (Góralczyk, 2017:156).

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<sup>1</sup> Xi made an extended tour of Europe, visiting Belgium, Germany, Bulgaria, Romania, and Hungary (spending the most time in Budapest).

<sup>2</sup> "China's Twelve Measures for Promoting Friendly Cooperation with Central and Eastern European Countries". [http://www.fmprc.gov.cn/mfa\\_eng/topics\\_665678/wjbispg\\_665714/t928567.shtml](http://www.fmprc.gov.cn/mfa_eng/topics_665678/wjbispg_665714/t928567.shtml)

<sup>3</sup> The northern land bridge(s) pass through the Baltic states and Poland before they reach Western Europe. The southern land bridge that connects China with the Middle East and Turkey reaches the Balkans and from there extends to other parts of Europe. The maritime route from the Suez Canal to the Piraeus Port in Athens heads north to Albania, Macedonia and Bulgaria. The maritime routes through the Black Sea lead to Bulgaria and Romania, and there are also maritime routes planned for the Adriatic and the Baltic coasts.

The soul of OBOR initiative is the openness and inclusiveness, which seeks to forge a Community of Shared Future for Mankind as a new development paradigm. Regarding the nature of Sino-CEE cooperation, this spirit is interpreted by Xi Jinping himself as the exploration of a new path of development relations with traditional friends, the innovative practice to develop China-Europe relations, and the establishment of a new platform for South-South with characteristics appropriate for North-South cooperation<sup>4</sup>. Xi's speech highlights China's understanding of specific features of CEE countries. On the one hand, they are deeply integrated into the Europe political sphere, which is the backbone of social and economic development of the region. Thus, China's cooperation with CEE is to strengthen Europe's unity instead of weakening it by offering its assistance in reducing gaps in development between countries. On the other hand, most of CEE countries are situated in a specific development phase, between that of an emerging and a developed economy, thus share certain common characteristics with developing countries, such as higher growth rates and lower labor costs, a considerable endowment with natural resources, and sizeable demand for investments in infrastructure, energy, agriculture and certain branches of manufacturing. As the 'outskirts' of the European Union, CEE countries provide space for South-South cooperation which complements and fills the gap left by traditional North-South cooperation scheme. In other words, Sino-CEE cooperation could blow fresh air in where existent cooperation paradigm led by the EU lost the momentum<sup>5</sup>.

Six years after the launch of 16+1 framework and five years after the announcement of OBOR initiative, to what extent this new South-South cooperation with North-South characteristics has been materialized, what are the differences between China's economic influence and that of the EU, and how China's ambition challenges the EU-CEE as well as EU-China relations? These are the questions that this paper tries to answer. In the following parts, through comparative analysis, we'll look at consecutively China's trade, FDI, and development finance pattern in CEE, each part starts with a presentation of available data followed by an analysis and a brief discussion. The conclusion about China's current and future economic engagement in CEE countries will be drawn in the end.

## **Trade**

China's trade with Europe is highly tilted toward Western Europe, especially those largest economies such as Germany, France, and UK. However, its trade linkage with CEE countries has been intensified since 2008. Given the high expectation of CEE partners to explore Chinese market, we'll look at first the exports from CEE region to China. As table 1 indicates, the average annual growth rate of CEE exports to China reached 11.4% against 2.1% to EU15. Therefore, Chinese market provided a cushion during the following years of the global financial crisis to compensate the loss of momentum of European core markets. This being said, from a very low level, an average double-digit growth rate in 8 years is not

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<sup>4</sup> "Xi Jinping meets with the leaders of the Central and Eastern European Countries that attend the fourth annual Sino-CEE summit". [http://www.xinhuanet.com/world/2015-11/26/c\\_1117275150.htm](http://www.xinhuanet.com/world/2015-11/26/c_1117275150.htm)

<sup>5</sup> Such vision is also shared by Hungary prime minister Orbán, who said that although Hungary's "ship is sailing in Western waters, the wind blows from the East." (Szunomár et al., 2014:37)

enough to change radically the relatively small importance of China at the aggregate level. Compared with 2008, CEE's total merchandise export value to China increased from 4.5 billion USD to 9.8 billion USD in 2016, raising China's share in total exports from 0.66% to 1.30%. Nevertheless, given the intra-regional concentration of CEE trade, China's import demand outpaced the rest extra-regional partners<sup>6</sup>, and became the fourth largest extra-regional export destination in 2016 behind Russia (21 billion), United States (18.5 billion) and Turkey (13.9 billion). At the country level, six countries stand out for the important role played by China. Considering the rank of China among extra-regional export destinations in 2016, China was the largest market for Albania and Montenegro, second largest for Bulgaria and Hungary, third largest for Slovakia and Slovenia.

Table 1: CEE cumulative merchandise exports to China and EU 15, 2008-2016 (billion \$)

|                        | China                      |                    |       | EU 15                      |                    |         |
|------------------------|----------------------------|--------------------|-------|----------------------------|--------------------|---------|
|                        | Average annual growth rate | Total export value | Share | Average annual growth rate | Total export value | Share   |
| CEE 16                 | 11.4%                      | 74.8               | 100%  | 2.1%                       | 3581.5             | 100.0 % |
| Albania                | 19.8%                      | 0.9                | 1.2%  | 9.8%                       | 11.3               | 0.3%    |
| Bosnia and Herzegovina | 33.6%                      | 0.2                | 0.2%  | 3.0%                       | 19.5               | 0.5%    |
| Bulgaria               | 20.7%                      | 4.4                | 5.9%  | 4.2%                       | 105.1              | 2.9%    |
| Croatia                | 14.4%                      | 0.5                | 0.7%  | 0.3%                       | 49.7               | 1.4%    |
| Czech Republic         | 13.2%                      | 13.9               | 18.6% | 2.1%                       | 852.2              | 23.8%   |
| Estonia                | 21.7%                      | 1.5                | 2.0%  | 3.3%                       | 63.6               | 1.8%    |
| Hungary                | 9.9%                       | 15.5               | 20.8% | -0.1%                      | 517.6              | 14.5%   |
| Latvia                 | 26.7%                      | 0.7                | 0.9%  | 3.5%                       | 32.7               | 0.9%    |
| Lithuania              | 26.3%                      | 0.8                | 1.0%  | 1.2%                       | 78.9               | 2.2%    |
| Macedonia              | 331.9%                     | 0.8                | 1.0%  | 6.9%                       | 20.9               | 0.6%    |
| Montenegro             | 134.2%                     | 0.0                | 0.1%  | -12.7%                     | 1.1                | 0.0%    |
| Poland                 | 5.7%                       | 16.3               | 21.8% | 2.3%                       | 1001.0             | 27.9%   |
| Romania                | 16.2%                      | 4.7                | 6.2%  | 4.6%                       | 291.3              | 8.1%    |
| Serbia                 | 30.6%                      | 0.1                | 0.2%  | 7.7%                       | 41.8               | 1.2%    |
| Slovakia               | 14.9%                      | 12.8               | 17.1% | 2.0%                       | 356.4              | 10.0%   |

<sup>6</sup> Extra-regional partners signify all the rest countries less EU 15 and CEE 16.

|          |       |     |      |      |       |      |
|----------|-------|-----|------|------|-------|------|
| Slovenia | 33.8% | 1.6 | 2.2% | 1.3% | 138.3 | 3.9% |
|----------|-------|-----|------|------|-------|------|

(Source: UNCTAD)

Considering the composition of China's imports from CEE countries<sup>7</sup>, we may distinguish two main drives behind China's import surge. On the one hand, China imported higher value-added items including automotive products, machinery, and electronics. This is especially the case for the more developed countries, such as Czech Republic, Hungary, and Slovakia; on the other hand, China imported lower value-added primary or resource-based products, such as ores, metal, and wooden products. While wooden products are the major exports from Baltic states (Estonia, Latvia, and Lithuania), China's imports of mineral resources and metal products are highly concentrated in the less developed countries, including Albania, Bulgaria and Montenegro<sup>8</sup>. As almost 80% of CEE's total exports to China came from Visegrad countries, the regional export structure with China largely reflected China's import need from these countries, characterized by a high percentage of medium and high technology manufactures. Even so, primary and resource-based products still accounted for 27% of China's imports from CEE. Clearly, during the last decade, CEE countries have enhanced their export relationship with China through a double-track pattern. Taking into account China's ongoing reduction of productive capacity in resource-intensive industries, and efforts to upgrade its manufacture sector, such trend is expected to be sustained in the future.

Table 2: Export composition of CEE countries with China, 2008-2016

|                        | Primary products | Resource-based manufactures | Low-tech manufactures | Medium-tech manufactures | High-tech manufactures |
|------------------------|------------------|-----------------------------|-----------------------|--------------------------|------------------------|
| CEE 16                 | 12.8%            | 14.4%                       | 8.3%                  | 49.9%                    | 14.3%                  |
| Albania                | 1.4%             | 90.6%                       | 3.8%                  | 1.4%                     | 0.0%                   |
| Bosnia and Herzegovina | 0.9%             | 36.2%                       | 44.5%                 | 17.1%                    | 1.2%                   |
| Bulgaria               | 64.1%            | 25.3%                       | 1.9%                  | 5.6%                     | 3.1%                   |
| Croatia                | 11.3%            | 19.3%                       | 22.9%                 | 37.2%                    | 9.0%                   |
| Czech Republic         | 1.6%             | 10.1%                       | 13.9%                 | 51.5%                    | 22.8%                  |
| Estonia                | 2.5%             | 42.4%                       | 6.3%                  | 19.9%                    | 28.9%                  |
| Hungary                | 1.4%             | 3.6%                        | 5.6%                  | 66.0%                    | 22.9%                  |
| Latvia                 | 2.5%             | 68.2%                       | 7.2%                  | 7.8%                     | 14.3%                  |
| Lithuania              | 1.6%             | 48.7%                       | 27.1%                 | 15.7%                    | 6.8%                   |

<sup>7</sup> In table 2 and table 4, we employ the technological classification proposed by Lall (2000).

<sup>8</sup> Poland also exports primary resources basically cooper which accounts for more than 30%.

|            |       |       |       |       |       |
|------------|-------|-------|-------|-------|-------|
| Macedonia  | 2.2%  | 1.3%  | 0.5%  | 95.7% | 0.3%  |
| Montenegro | 0.0%  | 95.7% | 0.1%  | 0.4%  | 3.2%  |
| Poland     | 37.3% | 17.0% | 10.3% | 24.6% | 10.7% |
| Romania    | 1.1%  | 44.5% | 5.6%  | 37.6% | 11.1% |
| Serbia     | 1.4%  | 31.7% | 35.0% | 19.7% | 11.7% |
| Slovakia   | 0.1%  | 1.1%  | 4.3%  | 91.8% | 2.6%  |
| Slovenia   | 1.9%  | 11.0% | 12.1% | 39.3% | 35.7% |

(Source: UNCTAD)

At the other side of trade balance sheet, the average annual growth of CEE's imports from China was 3.4% between 2008 and 2016, contrary to -0.2% with their western neighbors. Although relatively slower compared with the growth rate of China's imports from the region, it is worth noting that China already had a solid base in 2008, accounting for 6.4% of total merchandise imports of CEE countries, and was the fourth largest import source behind Germany, Russia, and Italy. Therefore, a moderate growth rate was enough to raise China's share to 9.6% in 2016 and transformed it to the second largest import source behind Germany at the regional level. At the country level, China exported more than any extra-regional partners to CEE countries, except Baltic states where Russia was ahead of China, Bosnia and Herzegovina where Turkey had more impact, and Bulgaria where China lagged behind both Russia and Turkey.

Table 3: CEE cumulative merchandise imports from China and EU 15, 2008-2016 (billion \$)

|                        | China                      |                    |         | EU 15                      |                    |         |
|------------------------|----------------------------|--------------------|---------|----------------------------|--------------------|---------|
|                        | Average annual growth rate | Total import value | Share   | Average annual growth rate | Total import value | Share   |
| CEE 16                 | 3.4%                       | 513.0              | 100.0 % | -0.2%                      | 3207.7             | 100.0 % |
| Albania                | 1.3%                       | 3.2                | 0.6%    | -0.5%                      | 24.2               | 0.7%    |
| Bosnia and Herzegovina | 7.4%                       | 2.7                | 0.5%    | -1.6%                      | 29.5               | 0.8%    |
| Bulgaria               | -2.3%                      | 10.2               | 2.0%    | 0.9%                       | 118.4              | 3.3%    |
| Croatia                | -10.2%                     | 10.4               | 2.0%    | -2.5%                      | 97.9               | 2.7%    |
| Czech Republic         | 6.3%                       | 142.6              | 27.8%   | 0.3%                       | 606.5              | 16.9%   |
| Estonia                | 9.3%                       | 8.1                | 1.6%    | 0.1%                       | 70.4               | 2.0%    |
| Hungary                | -2.2%                      | 48.8               | 9.5%    | -0.5%                      | 454.3              | 12.7%   |

|            |      |       |       |       |       |       |
|------------|------|-------|-------|-------|-------|-------|
| Latvia     | 6.4% | 3.5   | 0.7%  | 0.6%  | 49.3  | 1.4%  |
| Lithuania  | 2.3% | 6.4   | 1.2%  | 3.9%  | 99.7  | 2.8%  |
| Macedonia  | 4.2% | 3.2   | 0.6%  | 5.3%  | 24.3  | 0.7%  |
| Montenegro | 2.9% | 1.5   | 0.3%  | -3.1% | 6.8   | 0.2%  |
| Poland     | 4.9% | 170.7 | 33.3% | -0.9% | 861.3 | 24.0% |
| Romania    | 2.8% | 28.5  | 5.6%  | 0.7%  | 341.7 | 9.5%  |
| Serbia     | 0.5% | 13.1  | 2.6%  | 0.2%  | 64.7  | 1.8%  |
| Slovakia   | 6.7% | 46.3  | 9.0%  | 0.3%  | 215.1 | 6.0%  |
| Slovenia   | 0.9% | 13.6  | 2.6%  | -1.1% | 143.6 | 4.0%  |

(Source: UNCTAD)

Regarding the composition of CEE's imports from China, unsurprisingly, almost half of the imports were high technology manufactures, mainly electronics, followed by low technology manufactures, such as textile, and medium technology manufactures typically machinery. As CEE's exports to China were more concentrated in primary goods, resource-based manufactures and medium technology manufactures, we may assume an inter-industry trade pattern between CEE countries and China, which means that CEE countries were either final markets or the entry to European core markets for Chinese manufactures. Thus, it is understandable that China's export volume was largely determined by economic fundamentals, such as economic size and development level of individual countries. It is typically the case for high technology manufactures, which had much higher proportions in Visegrad countries. In the end, Czech Republic, Hungary, Poland and Slovakia represented 80% of China's total exports to CEE between 2008 and 2016. As a reference, the exports of EU 15 were geographically more diversified, with 67% concentrated in these four countries during the same period.

Table 4: Import composition of CEE countries with China, 2008-2016

|                        | Primary products | Resource-based manufactures | Low-tech manufactures | Medium-tech manufactures | High-tech manufactures |
|------------------------|------------------|-----------------------------|-----------------------|--------------------------|------------------------|
| CEE 16                 | 1.8%             | 4.0%                        | 24.1%                 | 19.6%                    | 49.8%                  |
| Albania                | 1.4%             | 6.5%                        | 34.5%                 | 31.1%                    | 18.6%                  |
| Bosnia and Herzegovina | 1.5%             | 7.8%                        | 34.8%                 | 29.0%                    | 26.8%                  |
| Bulgaria               | 4.0%             | 10.6%                       | 24.5%                 | 37.8%                    | 22.5%                  |
| Croatia                | 1.8%             | 5.1%                        | 41.1%                 | 20.6%                    | 31.1%                  |
| Czech Republic         | 1.0%             | 2.2%                        | 18.4%                 | 13.7%                    | 64.3%                  |



|            |      |       |       |       |       |
|------------|------|-------|-------|-------|-------|
| Estonia    | 1.0% | 4.9%  | 30.6% | 29.7% | 33.6% |
| Hungary    | 0.6% | 2.2%  | 7.6%  | 18.5% | 70.4% |
| Latvia     | 1.9% | 9.4%  | 30.9% | 20.0% | 37.6% |
| Lithuania  | 3.6% | 9.4%  | 37.0% | 26.9% | 22.9% |
| Macedonia  | 2.8% | 6.5%  | 28.5% | 25.0% | 35.9% |
| Montenegro | 0.8% | 5.4%  | 38.3% | 24.5% | 29.0% |
| Poland     | 2.6% | 4.0%  | 30.1% | 20.5% | 42.5% |
| Romania    | 3.4% | 7.9%  | 24.0% | 29.2% | 34.9% |
| Serbia     | 2.3% | 6.3%  | 27.5% | 25.2% | 28.1% |
| Slovakia   | 1.1% | 2.2%  | 23.6% | 18.7% | 54.3% |
| Slovenia   | 1.8% | 11.2% | 33.9% | 21.5% | 31.4% |

(Source: UNCTAD)

In the end, the trade pattern between CEE and China during 2008 and 2016 was characterized by one-way inter-industry trade<sup>9</sup>. In contrast to the general trade structure of CEE with the whole world and EU 15, which was sustained by intra-industry trade, 75.5% of CEE's total trade with China was one-way trade. Moreover, 70.7% of the trade was one-way imports from China. In this context, the trade deficits continued to be accumulated, reaching 438.2 billion \$ between 2008 and 2016, higher than CEE's net deficits with the whole world. This inter-industry trade pattern was observed across all individual countries, except Estonia, Hungary, Czech Republic and Slovenia, which exported relatively a noticeable share of high technology manufactures to China, indicating a bilateral exchange of goods especially in electronic sector. As consequence, none of CEE countries at any year between 2008 and 2016 gained trade surplus against China.

Table 5: Trade structure of CEE countries, 2008-2016 (billion \$)

|               | One-way trade (%) | - export oriented | - import oriented | Trade balance value |
|---------------|-------------------|-------------------|-------------------|---------------------|
| <b>CEE 16</b> |                   |                   |                   |                     |
| World         | 3.3%              | 0.0%              | 3.3%              | -383.6              |
| EU 15         | 3.5%              | 3.0%              | 0.5%              | 373.8               |
| China         | 75.5%             | 4.8%              | 70.7%             | -438.2              |

<sup>9</sup> At SITC 3-digit level, the bilateral trade of a given merchandise would be considered as one-way trade when the minority flow represents lower than 10% of the majority flow.

| <b>CEE countries with China</b> |       |       |       |        |
|---------------------------------|-------|-------|-------|--------|
| Albania                         | 88.7% | 15.8% | 72.9% | -2.2   |
| Bosnia and Herzegovina          | 89.1% | 2.2%  | 86.9% | -2.5   |
| Bulgaria                        | 86.0% | 26.0% | 60.0% | -5.8   |
| Croatia                         | 95.9% | 1.6%  | 94.3% | -9.9   |
| Czech Republic                  | 74.6% | 0.7%  | 73.9% | -128.7 |
| Estonia                         | 59.8% | 6.0%  | 53.8% | -6.6   |
| Hungary                         | 62.0% | 11.8% | 50.2% | -33.3  |
| Latvia                          | 80.0% | 10.0% | 70.0% | -2.8   |
| Lithuania                       | 86.6% | 4.4%  | 82.2% | -5.6   |
| Macedonia                       | 95.1% | 18.4% | 76.7% | -2.5   |
| Montenegro                      | 97.9% | 2.7%  | 95.2% | -1.5   |
| Poland                          | 83.1% | 4.0%  | 79.2% | -154.4 |
| Romania                         | 78.1% | 5.8%  | 72.2% | -23.9  |
| Serbia                          | 88.5% | 0.1%  | 88.4% | -13.0  |
| Slovakia                        | 88.1% | 16.4% | 71.6% | -33.5  |
| Slovenia                        | 75.4% | 1.7%  | 73.7% | -12.0  |

(Source: Author's own calculation)

Behind such trade pattern is the still underdeveloped direct connections between CEE and Chinese companies. During the transition to market economy, CEE countries went through radical economic changes induced by foreign capital (Rahman & Zhao, 2013; Damijan et al., 2013). The integration of 11 CEE countries in the EU has lured foreign multinationals to realize significant investment projects in this region establishing their own production networks. As both China and some CEE countries are deeply integrated into the global value chains weaved by multinationals, the trade pattern between them is largely shaped by strategies and interests of multinationals, which are sometimes out of control of sovereign countries<sup>10</sup>. More specifically, as Ando and Kimura (2013:210) told us, CEE region connects Asia and Europe in the following ways: First, due to the dominance of East Asia in the electronics industry, European multinationals have been importing electronic parts and components from their Asian affiliates and other Asian firms to use them for their production in the CEE region. Second, the automotive industry agglomerations in the CEE countries

<sup>10</sup> For example, the relocation of plants from Hungary decreased sharply engines delivered from Hungarian affiliate of the Volkswagen Group (Audi Hungaria) to the Chinese affiliate of the VW Group (Éltető & Szunomár, 2016:41).

import machinery parts and components from Asia, while exporting auto parts and vehicles to Asia. In this context, the bilateral trade figures between China and CEE countries might not tell the whole story. The deficits, as a result of more imports of intermediary goods from China, would be balanced by trade surplus with EU 15 countries, which serve as the end market of final products incorporating imported pieces from China. Nevertheless, in the meantime, this may suggest that Sino-CEE trade relations are confined to the market power and subject to the independent decisions of European multinationals. The trade volume is hard to be boosted<sup>11</sup> and the trade asymmetry is difficult to be remedied only through bilateral negotiations. For smaller states, however, China's growing import demands of primary goods and resource-based manufactures<sup>12</sup>, which are also the defining feature of China's trade relations with other developing countries, seems a promising new path to enhance the trade relationship in the short and medium term. In the long run, it depends on the investment carried by Chinese multinationals in the region, as their European counterparts, to promote and develop bilateral trade in goods and services.

### **ODI**

If trade data between CEE and China are abundant and relatively reliable because of consistent custom control of entry and exit of merchandises, the precise estimation of China's direct investment in CEE is much more challenging. China, adopting the international definition of FDI elaborated by OECD and IMF<sup>13</sup>, established its own statistical system of ODI in 2002, and published for the first time the Statistic Bulletin of China's Outward Foreign Direct Investment (Bulletin hereafter) in 2003. Since then, we have public access to China's ODI flows and stocks disaggregated at country level which are updated annually. According to the latest official data, China's ODI stocks in CEE 16 countries amounted to 1.7 billion USD. As found in other countries, China's ODI statistics are limited to report direct investing destinations of Chinese enterprises, thus disguising round-tripping or trans-shipping FDI transactions. Taking into account the fact that 72% of China's ODI in the world at the end of 2017 were concentrated in Hong Kong, Cayman Islands, and Virgen Islands, we may have very limited information about ultimate investing destinations of a big part of China's ODI, causing underestimation of Chinese ODI in CEE.

Recognizing this well-known flaw of traditional statistic reporting mechanism, OECD in recent years urged its member states to distinguish immediate investors from ultimate investors, in order to produce more meaningful data for national policies<sup>14</sup>. The efforts carried by certain CEE countries give us a glimpse into how much difference could be caused by

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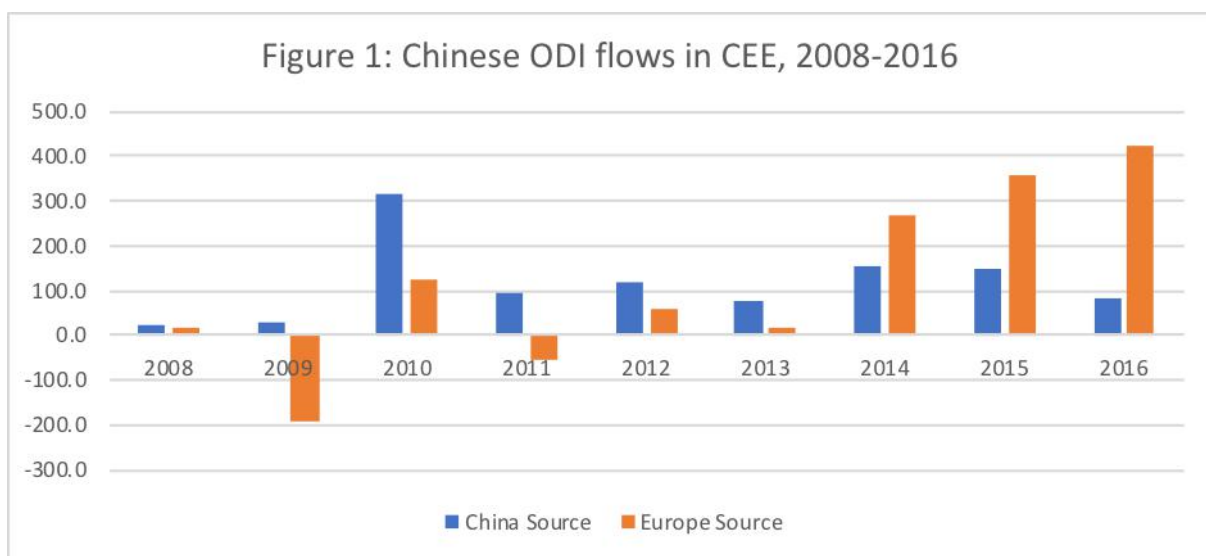
<sup>11</sup> The total trade between China and CEE countries by 2015 fell short to meet the goal set by Wen Jiabao in 2012, who had claimed to reach 100 billion USD.

<sup>12</sup> Resource-based manufactures include agro-based one, which increased by 17% annually due to China's authorization and simplification of food imports, such as pork, fish, fruit and lactic products.

<sup>13</sup> The benchmark definition of Foreign Direct Investment refers to an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. A threshold of 10 per cent of equity ownership is often used to qualify an investor as a foreign direct investor. The forms of investment by the direct investor which are classified as FDI are equity capital, the reinvestment of earnings and the provision of long-term and short-term intra-company loans (between parent and affiliate enterprises).

<sup>14</sup> OECD. "Implementing the latest international standards for compiling foreign direct investment statistics". 2015. <https://www.oecd.org/daf/inv/FDI-statistics-by-ultimate-investing-country.pdf>

these two calibers. For example, in Hungary, at the end of 2014, the investment stocks by ultimate investors identified as Chinese were 1.27 billion USD<sup>15</sup>, 5.7 times the direct investment realized by enterprises registered in China. In Poland, in the same year, the investment stocks ultimately from Chinese enterprises were 501 million USD against only 179 million USD following the old reporting method<sup>16</sup>. In other words, the ODI stocks *de facto* Chinese in Hungary and Poland in 2014 were larger than total ODI stocks reported by the Chinese official source in the whole CEE. Unfortunately, this new ODI tracking system is still in its early phase with scattered data that cannot allow the comparable analysis throughout years and countries. Therefore, the Eurostat which we count on still follows the standard presentation of FDI statistics by the immediate source of the funding, bearing the same risk as Chinese official data to underestimate Chinese ODI in the region.



\*ODI flows are reported in million Euro at current price. To convert RMB to Euro, we use reference exchange rate of RMB period average found at <http://data.stats.gov.cn/english/easyquery.htm?cn=C01>.

(Source: China source refers to 2016 Statistic Bulletin of Outward Foreign Direct Investment. Europe source refers to Balance of payments-international transactions of Eurostat <http://ec.europa.eu/eurostat/web/balance-of-payments/data/database> for EU member states in CEE, and data from individual central banks of Serbia, Macedonia, Albania, and Montenegro. ODI flows to Montenegro between 2008-2012 are based on UNCTAD Bilateral FDI Statistics.)

Curiously, by putting side by side Chinese and European data concerning China's ODI flows in CEE between 2008 and 2016 (figure 1), we may notify big discrepancies between two sources. In the first place, before 2014, Chinese ODI flows to CEE, according to the European source, were more volatile and consistently lower in absolute value than that reported by Chinese source<sup>17</sup>. One of the reason might be the overestimation of Chinese net

<sup>15</sup> OECD.stat, FDI statistics according to Benchmark Definition 4th Edition (BMD4).

<sup>16</sup> Romania, a non-OECD country, also claimed Chinese ODI stocks of 420 million euros – which were more than triple the Chinese official figure and six times larger than the EU ones. (Pencea and Oehler-Sincai, 2015:52)

<sup>17</sup> At the country level, while it is true that the volatility of rise and fall of Chinese ODI flows is higher according to European source, the absolute value is not necessarily always lower.

ODI flows. In fact, as shown in Table 6, China's annual reports of balance of payment provided clear evidence that ODI flows calculated by the authoritative bulletins were much closer to the gross ODI outflows before deducting all kinds of reverse investment.

Table 6: Comparison of ODI flows between Bulletin and Balance of Payment reports  
(billion \$)

|               | 2008 | 2009 | 2010 | 2011 | 2012 | 2013  | 2014  |
|---------------|------|------|------|------|------|-------|-------|
| ODI flows     | 55.9 | 56.5 | 68.8 | 74.7 | 87.8 | 107.8 | 123.1 |
| ODI outflows  | 55.6 | 48.1 | 67.8 | 67.1 | 85.7 | 109.6 | 135.9 |
| ODI inflows   | 2.2  | 4.2  | 7.6  | 17.4 | 23.4 | 36.4  | 55.5  |
| Net ODI flows | 53.5 | 43.9 | 60.2 | 49.7 | 62.3 | 73.2  | 80.4  |

(Source: ODI flows are the data provided by 2016 Statistic Bulletin of Outward Foreign Direct Investment. ODI outflows and inflows are found on annual reports of balance of payment before 2015)

As China started the transition to BPM 6 in 2014, its annual reports of balance of payment stopped to give any details on directions of ODI, we are not sure whether this problem has been solved in 2015 and 2016. However, it is curious to find out that from 2014 onwards, European source recorded a sudden jump of Chinese ODI in CEE which is increasing every year, while Chinese source gave more conservative figures. This discrepancy suggests the underestimation from the Chinese side during the last three years due to several big M&A transactions, which might go under the radar of Chinese authority<sup>18</sup>. Facing the overestimation as well as underestimation of ODI flows, Chinese authorities sometimes conducted revisions of historic ODI stocks in selected countries. This process helped to correct, to a certain extent, the errors accumulated during years by flawed ODI flows reporting system<sup>19</sup>. Nevertheless, this revision mechanism to the best is sporadic and unsystematic. Therefore, we assume a better data quality from CEE hosting countries. Moreover, the Eurostat and the data compiled from central banks of individual countries allow us to make the comparison of investment pattern between China and EU15 in the region at sectoral level.

<sup>18</sup> The most illustrating case was the Czech Republic, whose central bank reported 249.8 and 284.9 million euros of Chinese ODI flows respectively in 2015 and 2016, while Chinese government estimated -17.4 and 1.85 million USD during the same years. In fact, according to the data retrieved from Thomson One M&A database at April 3<sup>rd</sup> of 2018, one can be sure that CEFC China Energy Company Limited (CEFC China) has completed at least a number of sizeable M&A transactions in the Czech Republic during 2015 and 2016, including acquiring 49.92% of the biggest Czech airline company Travel Service, and holding 59.97% of the oldest Czech football club SK Slavia Praha. Besides, the company at its own webpage also acclaimed to acquire the largest Czech online travel agency Invia.cz, the fifth largest Czech brewer Pivovary Lobkowicz Group, five-star hotels such as Mandarin Oriental Prague and Le Palais Art Hotel Prague, high-end, metallurgy and engineering company ŽDAS, and several real-estate assets in Prague.

<sup>19</sup> The 2016 Bulletin revised China's ODI stocks in Bulgaria, Hungary, Poland, and Slovakia. In all four countries, the stocks were reduced from the baseline in 2015, suggesting a possible overestimation in previous years. For example, China's ODI stocks in Hungary, despite 57.46 million USD flows in 2016, remained 313.7 million USD, which were 257.41 million USD less than that in 2015, but became much closer to 279.1 million euros as provided by its Hungarian counterpart.

Table 7: ODI stocks in CEE countries of China and EU15, 2016 (million Euro)

|                        | China  | Percentage | EU 15    | Percentage |
|------------------------|--------|------------|----------|------------|
| CEE 16                 | 1480.4 | 100%       | 500674.4 | 100%       |
| Albania                | 1.9    | 0%         | 2163.3   | 0%         |
| Bosnia and Herzegovina | 7.8    | 1%         | 9211.4   | 2%         |
| Bulgaria               | 122.9  | 8%         | 25325.6  | 5%         |
| Croatia                | 1.2    | 0%         | 18835.6  | 4%         |
| Czech Republic         | 501.7  | 34%        | 88203.3  | 18%        |
| Estonia                | 12.0   | 1%         | 13555.1  | 3%         |
| Hungary                | 279.1  | 19%        | 57098.9  | 11%        |
| Latvia                 | 77.0   | 5%         | 6413     | 1%         |
| Lithuania              | 3.9    | 0%         | 7840.8   | 2%         |
| Macedonia              | 36.7   | 2%         | 2499.9   | 0%         |
| Montenegro             | 4.9    | 0%         | 2760.7   | 1%         |
| Poland                 | 123.7  | 8%         | 154909.4 | 31%        |
| Romania                | 56.4   | 4%         | 56042.8  | 11%        |
| Serbia                 | 207.2  | 14%        | 17218.0  | 3%         |
| Slovakia               | 32.9   | 2%         | 29127.8  | 6%         |
| Slovenia               | 11.2   | 1%         | 9468.8   | 2%         |

(Source: the data of 11 countries with EU member state status come from Eurostat which excludes SPE FDI, other five countries come from their central banks. Chinese ODI stocks in Serbia equal stock in 2015 plus 2016 flow. Its ODI stocks in Albania refer to investment position at the end of year 2015. Its ODI stocks in Montenegro equal stock in 2013 plus flows between 2014 and 2016. China source is used for the ODI stocks in Bosnia and Herzegovina. ODI stocks of EU 15 in these five countries are calculated in the following way. Stocks in Serbia equal stock in 2015 plus 2016 flow. Stocks in Albania refer to investment position at the end of year 2015. Bosnia Central Bank didn't include Finland, Greece and Portugal, exchange rate 30/12/2016 (1 BAM = 0.507800 EUR) is used for the conversion. Stocks in Montenegro equal stock in 2015 plus flows in 2016 (which not include Finland, Greece, Ireland and Portugal)

As shown in Table 7, China's ODI stocks in CEE region at the end of the year 2016 were equivalent to 1.48 billion euros, which were 0.24% of the investment positions realized by enterprises from EU 15 countries. In none of the 16 countries, China represented more than 1% of their FDI stocks. Given the recent rapid growth, the accumulated China's ODI flows accounted for 1.5% of total FDI inflows into the region between 2014 and 2016, and represented respectively 4.7%, 3.4%, 3.2% and 2.9% of FDI received by Czech Republic, Macedonia, Serbia and Latvia during the same period. Therefore, China's ODI in CEE is not

only a very recent phenomenon but also relatively more dynamic in a small number of countries, resulting in a somehow different distribution pattern. In the first place, while Visegrad countries hosted relatively 66% and 63% of ODI stocks from EU 15 and China, it was the Czech Republic instead of Poland that captured a bulky 34% of Chinese investment stocks[ It should bear in mind that as Chinese enterprises might conduct much more investment through third country, more precise data would possibly alter this conclusion. Nonetheless, even taken into account this factor, it seems that Hungary would benefit much more from the re-estimation than Poland.]. Therefore, Czech Republic is by far the favorite investing destination of China thanks to the closer political and economic linkage developed in the latest few years, followed by Hungary which enjoyed a historical friendly relationship with China and the largest Chinese diaspora in CEE. In the second place, Serbia, Latvia, and Macedonia, which are the minor focus of European investors, accounted for 21% of China's ODI stocks with Serbia alone hosting 14%. Although it is true that because of a very short history of China's ODI in CEE, it is still far away to be stable enough to reflect an established investment pattern, the available data indicates certain unique characteristics of China's investing motivations and strategies.

Table 8: China's ODI stocks in CEE 11 countries by sector, 2015 (million Euro)

|   | Bulgaria | Czech | Estonia | Croatia | Latvia | Lithuania | Hungary | Poland | Romania | Slovenia | Slovakia | Total |
|---|----------|-------|---------|---------|--------|-----------|---------|--------|---------|----------|----------|-------|
| <b>Manufacturing</b>  | 5        | 29.8  | -5.5    | 2.7     | 0      | -0.7      | 45.2    | 102    | 23      | -0.3     | 8.7      | 209.9 |
| textiles and wearing apparel                                  | 0.0      | 0.2   | 0.0     | 0.0     | 0.0    | 1.1       | :       | 3.5    | :       | 0.0      | :        | 4.8   |
| chemicals and chemical products                               | -0.1     | -0.7  | :       | 0.0     | 0.0    | :         | 81.5    | 2.7    | :       | 0.0      | 0.0      | 83.4  |
| basic pharmaceutical products and pharmaceutical preparations | -0.1     | :     | 0.0     | 0.0     | 0.0    | 0.0       | :       | 37.0   | 0.0     | -0.2     | 0.0      | 36.7  |
| computer, electronic and optical products                     | 0.5      | 26.6  | -5.9    | 1.7     | 0.0    | :         | 1.8     | 42.0   | 0.0     | 0.0      | 0.7      | 67.4  |
| <b>Electricity, gas, steam and air conditioning</b>           | 44.8     | 0     | 0       | 0       | 0      | 0         | 0       | 0      | 29.4    | 0        | 0        | 74.2  |

|   |      |       |      |     |     |     |      |      |      |     |     |       |
|---|------|-------|------|-----|-----|-----|------|------|------|-----|-----|-------|
| <b>supply</b>   |      |       |      |     |     |     |      |      |      |     |     |       |
| <b>Wholesale and retail trade; repair of motor vehicles and motorcycles</b> | 32.5 | 29.2  | 11.8 | 0.0 | 3.0 | 0.2 | 43.7 | 34.4 | 19.0 | 2.7 | 5.1 | 181.6 |
| <b>Financial and insurance activities</b>                                   | 0.0  | 107.0 | 0.0  | 0.0 | 0.0 | :   | :    | 0.1  | :    | 0.0 | 0.0 | 107.1 |
| <b>Real estate activities</b>   | 2.0  | -7.9  | 4.6  | 0.0 | 0.0 | 0.3 | 7.6  | 0.1  | 71.8 | 0.0 | 0.0 | 78.5  |
| <b>Professional, scientific and technical activities</b>                    | 4.8  | 95.1  | 0.0  | 0.0 | 0.0 | :   | 53.4 | 45.4 | :    | 0.2 | :   | 198.9 |
| <b>Construction</b>   | 0.5  | 0.0   | :    | 0.0 | 0.0 | 0.0 | 0.0  | 10.5 | 64.8 | 0.0 | 0.0 | 75.8  |

(Source: Eurostat)

Theoretically, according to Dunning's eclectic paradigm, academics would attribute ODI to four kinds of motivations of investing enterprises, namely resource-seeking, efficiency-seeking, market-seeking, and strategic-asset-seeking. Resource-seeking motivation refers principally to the exploitation of natural resources whose endowment is largely given. This kind of investment is expected to be concentrated in mining and quarrying industry sector. Both China and EU 15 seem lacking resource-seeking motivation in investing in CEE. Statistically, China's ODI stocks in mining and quarrying sector were null, while that corresponding to EU15 represented only 0.7% of its total ODI stocks in the region. Efficiency-seeking motivation is explained by the intent of investing enterprise to take advantage of differential factor costs to improve its total factor productivity and enhance its competitiveness in the given market. This motivation is especially evident when the investing enterprise enjoys specific advantages, which allow it to reconfigure the production network by allocating the resources among countries according to their respective factor endowment. As enterprises from European core economies are generally more competitive and have more market power than their Eastern European counterparts, their investment in CEE is marked by a strong efficiency-seeking motivation particularly in medium and high technology manufacturing sectors, such as chemical, pharmaceutical and automotive industries, which accounted for 45% of total manufacturing ODI stocks in CEE from EU15. Investment in labor-intensive textile and apparel industry is also lured by lower labor cost found in CEE.

In the case of China, the motivation behind its investment in the manufacturing sector is more ambiguous. Chinese enterprises, as indicated by the trade structure between China and CEE, are mostly competitive in electronics, telecommunication equipment, machinery and textile/apparel products. As the labor cost in China continues rising, one may expect the



seeking of efficiency by dislocating labor-intensive manufacturing to certain CEE countries<sup>20</sup>. However, China's ODI stocks in the manufacture of textiles and wearing apparel were negligible. Most of China's ODI stocks in manufacturing were divided into two groups. On the one hand, there was a sizeable investment in the manufacture of computer, electronic and optical products. Two-thirds of these investments were in Poland, while another one third was hosted by the Czech<sup>21</sup>. On the other hand, there was even more investment in the manufacture of chemicals and chemical products, which were almost totally concentrated in Hungary, as well as manufacture of basic pharmaceutical products and pharmaceutical preparations, which screwed toward Poland. In the latter case, it is arguable whether the investment is backed up by efficiency-seeking motivation. Once we examine the trade balance sheet of China, we would find that China is by far the net importer of chemical and pharmaceutical products. The investment of Chinese enterprises in these two sectors is rather aiming to enhance the operations of the investors in their home market, thus falling into the definition of strategic-asset-seeking motivation (Meyer, 2015:60).

Considering the market-seeking motivation, enterprises would naturally invest in where market potential is great which is proportional to the economic or population size. While European enterprises followed this logic concentrating 43% of their investment in wholesale and retail trade in Poland, the biggest economy of CEE, Chinese enterprises distributed more evenly their investment across Hungary, Czech Republic, Poland, Bulgaria, and Romania, targeting not only the local market but also the EU regional market. Here, CEE countries are considered as bridges connecting to European core markets rather than the final destinations themselves for Chinese goods. The commercial networks waved by Chinese immigrants became an influential factor. Finally, the strategic-asset-seeking motivation, besides the investment in high technology manufacturing sectors discussed formerly, was also manifested by the investment in services, especially financial and insurance activities. By far, the most active Chinese investor in this area was CEFC, whose investment was completely tilted toward the Czech. Through its second headquarter in Prague as a financial investment platform, CEFC's investment spanned to travel, commercial real estate, football club and media, which were included in the category "Professional, scientific and technical activities" of table 8. Total investment in financial and headquarter activities reached 202 million euros in 2015, which represented 86% of China's ODI stocks in the Czech Republic and changed greatly China's investment landscape in Visegrad countries.

China's investment activities in less developed economies are much more opaque. Nevertheless, we may highlight the case of Serbia where China's ODI was predominantly driven by its engagement in the steel industry. According to Thomson One M&A database, all five M&A transactions taken place in Serbia concern steel industry, with total investment value equivalent to 209 million USD, including the iconic acquisition of Zelezara Smederovo

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<sup>20</sup> In early 2000s, Chinese official guidelines, such as "Outbound Foreign Investment Catalogue" of 2004, did encourage Chinese companies to invest in Romania, one of the EU country with the lowest unit labor cost. According to Pencea and Oehler-Sincai (2015:50), the factual investments in 2005, made by SMEs involved in trade or in low-to-medium technology manufacturing, also favored Romania, which hosted two thirds of the overall Chinese investment stock in CEE.

<sup>21</sup> This confirms the prior studies on Chinese ODI in Poland (Heiduk & McCaleb, 2014:65) and Czech Republic (Fürst, 2014:82).

do by He Steel Group Co Ltd, and purchase of Smederevo dp by Hebei Iron & Steel Co Ltd. Given the fact that China is the largest exporter of metal products and increasing trade barriers against direct imports of such goods from China, the investment in metal industry has an implicit market-seeking motivation, thanks to the trade arrangement between EU member states and EU's attitude toward Serbia<sup>22</sup>. In addition, according to Crossborder Investment Monitor 2015 of Financial Times<sup>23</sup>, 51 of 70 Chinese greenfield projects in the Balkans region between January 2003 and January 2015 were concentrated in Romania and Bulgaria, led by projects in communications and in renewable or alternative energy. China's engagement in the energy sector in Romania and Bulgaria was consistent with our data compiled in Table 8. Romania hosted also the most of China's construction and real estate development projects.

In summary, there are two forces and four drivers of China's ODI in CEE during the last decade. Regarding two forces, first, while historically small private enterprises were the main actors involved in investment in trade and manufacturing activities, during recent years after the global financial crisis, large companies have shown more interests in investing in CEE. Albeit a numerous number of private SMEs, their investment scale is not comparable with that of large companies. Thus, these new players with their large-scale projects alter radically the distribution of Chinese ODI stocks in CEE. Second, M&A instead of greenfield investment became the mainstream entry mode of Chinese companies. Despite higher values of M&As, these transactions may not be exciting in the eyes of hosting governments, which wish to draw more fresh capital to create jobs (Heiduk & McCaleb, 2014:70). Considering four drivers, in the first place, as byproduct of Chinese government's encouragement of overseas investment, certain enterprises, such as CEFC, have shown strong motivation to reallocate their resources overseas by diversifying their asset portfolios. However, such projects are not necessarily consistent with government strategy and subject to stricter political scrutiny in the following years<sup>24</sup>. In the second place, China's ODI follows its trade expansion in CEE favoring those countries that have more intensive trade linkage with China. Such projects are either market-seeking or efficiency-seeking or combining two motivations together by investing in trade activities and localizing parts of production and service. In the third place, like China's ODI in Western Europe, China's ODI in CEE is also pushed by strong strategic-asset-seeking motivation by acquiring technologies, know-how, and production facility to compensate its disadvantages in particular sectors, such as chemical, pharmaceutical, and automotive industries. Those projects are logically lured to where development level and FDI agglomeration effect are higher, such as Poland and Hungary. In the final place, while Chinese increasing imports of primary products from less developed

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<sup>22</sup> "European Commission drops Serbian steel makers from anti-dumping list". <https://seenews.com/news/european-commission-drops-serbian-steel-makers-from-anti-dumping-list-586084>

<sup>23</sup> Wade Jacoby, "Chinese investment in the Balkans". <http://councilforeuropeanstudies.org/critcom/chinese-investment-in-the-balkans/>

<sup>24</sup> Since the end of 2016, China's authority began to strength the monitoring of Chinese ODI, particularly limiting the irrational investment behavior. In August 2017, "Guideline to further orientating and regulating the outward direct investment" was promulgated, limiting explicitly overseas investment in real estate, hotels, studios of cinema, entertainment, and sports clubs, as well as the establishment of equity investment funds or investment platforms without specific industrial projects. In December 2017, two more regulations were published consecutively: "Regulations of Private Enterprises' Overseas Investment Operation" and "Management Measures of Corporate Overseas Investment". "Regulations of State-owned Enterprises' overseas investment operation" and "Overseas Investment Regulations" are also on the way to be announced.

economies have not been translated into direct investment in mining and quarrying sector, Chinese companies did participate actively in privatization programs of heavy industry in these countries, such as Serbia, and showed special interests in energy and other infrastructure sectors. China's ODI in less developed and smaller CEE economies marks thus a special feature of investment behaviors of Chinese enterprises, which are related and consistent with OBOR initiative, that encourages the cooperation of productive capacities and prioritizes the infrastructure connectivity.

These two forces and four drivers suggest the biggest difference of Chinese investors from their European counterparts in terms of specific institutional factors (McCaleb & Szunomár, 2014:122). As the latecomer to outward investment, Chinese companies generally lack experience and expertise to evaluate and grasp business opportunities in the culturally different area. Traditionally, private enterprises count on the informal network, such as local Chinese immigrants, to reduce the foreignness liability. More recently, the bilateral political connection seems more eminent to explain different evolutions in the volumes of Chinese ODI attracted by CEE countries. This political connection is not confined to governmental level dialogue and negotiation, neither implies the politicization of Chinese ODI. The rationale behind the importance of political connection is that, given the increasing interests of Chinese investors in M&A and privatization of state enterprises, the timely communication of available opening opportunities becomes critical. The successful stories include the buyout of Hungarian BorsodChem by Chinese Wanhua thanks to Orbán's visit to China at the end of 2010, and the expansion of CEFC in the Czech Republic because of the personal close relationship between the founder and Czech's president Zeman<sup>25</sup>. On the contrary, Romania, lack of specific strategy, made Chinese investors arrive too later to take full advantage of the Romanian "green certificate" incentive program for renewable energy industry (Pencea & Oehler-Sincai, 2015:53). In this context, China's future ODI in CEE countries would be largely shaped and influenced by policy coordination and bilateral political factors, especially that in the hosting CEE countries, such as the development of specific promotion agency, the coherence of their succeeding governments in their bilateral relations with China, and their obstinacy and insistence on negotiating and concluding cooperation agreements.

### **Development Finance**

China's ODI is often confused with development finance. The most outrageous example is America Enterprise Institute's China Global Investment Tracker which mixes without careful distinction entrepreneurial activities and public projects with Chinese official loans. However, these two forms of capital flows refer to qualitatively different situations. On the one hand, ODI results from decision making of economic entities, who bear directly the investment risks. On the other hand, development finance through government channel is actually debts carried by hosting countries, who have to repay the debts ultimately according to the schedule arranged. As China is not a member of DCA, its definition of international aid

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<sup>25</sup> Ye Jianming, the founder and chairman of CEFC, was named an economic advisor to Czech President Milos Zeman in 2015.

or development finance is not consistent and compatible with internationally acknowledged criteria<sup>26</sup>, making the calculation of Chinese development finance the trickiest task to fulfill, especially for the purpose to compare it with other DCA counterparts. Some researchers have arrived at their own estimation of China's overall development assistance based on publicly available reports and information from the Chinese side. For example, according to Kitano and Harada (2016:1057), net disbursements of preferential export buyer's credits were estimated to total 7.0 billion USD in 2013, which is almost the same amount of total net foreign aid consisting of grants and interest-free loans, concessional loans and multilateral aid. Nevertheless, those findings rarely provided any detailed insights on Chinese development finance at the country or sectoral level. Other third parties tried to construct their own database for specific purposes, such as China-Latin America Finance Database by the Inter-American Dialogue through careful examination of government, bank, and press reports from both China and recipient countries; and CARI Loan Database compiled by Brautigam and her researching team at SAIS of Johns Hopkins through qualitative fieldwork methodology. Regarding Chinese development finance in CEE, to our best knowledge, AidData project<sup>27</sup> is the only database with sufficient detailed information. Although its media-based approach to data collection is criticized by those who prefer more solid field-work approach, recent findings employing ground-truthing methodology in Africa (Muchapondwa et al., 2016:791) justified that media information, when carefully checked, could serve at least a solid start for academic analysis.

According to AidData's Global Chinese Official Finance Dataset, 2000-2014, Version 1.0, China's development finance commitments, which are the sum of grants, ODA-like loans, and OOF-like loans<sup>28</sup>, reached a total value of 4.88 billion USD between 2009 and 2014 in CEE. During the same time, DAC EU members promised an allocation of 3.79 billion USD in the region while multilateral institutions committed another 21.39 billion USD. In other words, China's development finance commitment in CEE was already larger than the total sum through the bilateral channel within EU, and equivalent to 23% of assistance provided by the multilateral platform. Given the nature of development finance, all the donors targeted principally the most underdeveloped countries in CEE, comprised of five currently non-EU members. Besides, Bulgaria hosted four minor symbolic and representative projects of China, while Croatia received 1.5% of finance coming from EU neighbors and

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<sup>26</sup> For more discussion of this issue, see Bräutigam (2011).

<sup>27</sup> AidData uses the method named Tracking Underreported Financial Flows (TUFF), which draws from open-source information produced by the media, scholarly research, and government reports and databases. The application of the TUFF methodology resulted in the publication of a database (available at [china.aiddata.org](http://china.aiddata.org)) that captures 1,955 Chinese-sponsored projects worth approximately \$83.3 billion in financial commitment.

<sup>28</sup> Other official flows (OOF) are defined by DAC as official sector transactions that do not meet official development assistance (ODA) criteria. OOF include: grants to developing countries for representational or essentially commercial purposes; official bilateral transactions intended to promote development, but having a grant element of less than 25%; and, official bilateral transactions, whatever their grant element, that are primarily export-facilitating in purpose. This category includes, by definition: export credits extended directly to an aid recipient by an official agency or institution (official direct export credits); the net acquisition by governments and central monetary institutions of securities issued by multilateral development banks at market terms; subsidies (grants) to the private sector to soften its credits to developing countries; and, funds in support of private investment. It should be notified, in the following part, OOF loans both for China and other donors exclude export credits.

9.9% of that flown from multilateral institutions. Despite the overlap of beneficiary states, China's development finance is characterized by the over dependency on loan form.

Table 9: 2009-2014 official development finance commitments in CEE (million \$)

|                | Grant    | ODA-like loan | OOF-like loan | Total     |
|----------------|----------|---------------|---------------|-----------|
| China          | 17.67    | 2,829.77      | 2,034.32      | 4,881.76  |
| %              | 0.4%     | 58.0%         | 41.7%         |           |
| DAC EU members | 1,969.54 | 1,470.66      | 351.20        | 3,791.41  |
| %              | 51.9%    | 38.8%         | 9.3%          |           |
| Multilaterals  | 4,140.40 | 4,561.79      | 12,687.27     | 21,389.46 |
| %              | 19.4%    | 21.3%         | 59.3%         |           |

(Source: AidData, OECD stat; 2014 constant price for China and 2015 constant price for others, OOF exclude export credits)

Table 10 further disaggregates the development finance from China as well as European countries and multilateral institutions by activities. As expected, all donors used most part of their grants to finance social infrastructure and services. What distinguishes China from other donors was not only the predominance of loan forms, but also the high sectoral concentration of loan destination in economic infrastructure and services, with more than 2 billion USD each in transport and energy, altering therefore completely the financial landscape of these two specific areas. In the transport and storage, Chinas' official loans amounted to 2.2 billion USD, equivalent to more than half of the loans generated by multilateral institutions. In the energy sector, China's official loans were even larger, reaching 2.7 billion USD when combing ODA-like and OOF-like loans, which were 42% larger than the sum of the loans accorded by EU countries and multilateral institutions. More interestingly, China seems to count on different loan instruments for different ends. Its finance in transport and storage took the form of ODA-like concessional loans, highlighting the development nature of these projects given the long investment cycle and pro-public interest characteristic. On the contrary, most of the financial arrangement for energy projects was OOF-like loans, reflecting more commercial interests. Such approach was also manifested by China's increasing ODI in the energy sector through M&A transactions. In the end, the surge of China's development finance in CEE was accompanied by very specific orientation, filling the gap of insufficient finance in transport and energy infrastructure, where traditional donors were reluctant to enter.

Table 10: Disaggregation of development finance by activities, 2009-2014 (million \$)

| <b>Grant</b> |   |   |                     |        |                            |                     |               |              |
|--------------|---|---|---------------------|--------|----------------------------|---------------------|---------------|--------------|
|              | <b>Social Infrastructure &amp; Services</b> | <b>Economic Infrastructure &amp; Services</b> | Transport & Storage | Energy | <b>Producti on Sectors</b> | <b>Multi-Sector</b> | <b>Othe r</b> | <b>Total</b> |
| China        | 11.44                                       | -   | -                   | -      | 0.68                       | 1.99                | 3.56          | 17.67        |

|                 |                                  |                                    |                     |          |                    |              |        |           |
|-----------------|----------------------------------|------------------------------------|---------------------|----------|--------------------|--------------|--------|-----------|
| %               | 64.8%                            | 0.0%                               | 0.0%                | 0.0%     | 3.9%               | 11.2%        | 20.2%  |           |
| DAC EU members  | 1,488.92                         | 164.21                             | 43.12               | 42.27    | 103.45             | 128.34       | 84.61  | 1,969.54  |
| %               | 75.6%                            | 8.3%                               | 2.2%                | 2.1%     | 5.3%               | 6.5%         | 4.3%   |           |
| Multilaterals   | 1,861.50                         | 553.98                             | 353.15              | 99.79    | 421.24             | 1,059.29     | 244.40 | 4,140.40  |
| %               | 45.0%                            | 13.4%                              | 8.5%                | 2.4%     | 10.2%              | 25.6%        | 5.9%   |           |
| <b>ODA loan</b> |                                  |                                    |                     |          |                    |              |        |           |
|                 | Social Infrastructure & Services | Economic Infrastructure & Services | Transport & Storage | Energy   | Production Sectors | Multi-Sector | Other  | Total     |
| China           | -                                | 2,829.77                           | 2,187.12            | 642.66   | -                  | -            | -      | 2,829.77  |
| %               | 0.0%                             | 100.0%                             | 77.3%               | 22.7%    | 0.0%               | 0.0%         | 0.0%   |           |
| DAC EU members  | 246.36                           | 1,123.73                           | 36.00               | 904.81   | 63.41              | 37.16        | 0.00   | 1,470.66  |
| %               | 16.8%                            | 76.4%                              | 2.4%                | 61.5%    | 4.3%               | 2.5%         | 0.0%   |           |
| Multilaterals   | 701.84                           | 3,072.20                           | 1,639.79            | 92.72    | 643.31             | 52.57        | 91.87  | 4,561.79  |
| %               | 15.4%                            | 67.3%                              | 35.9%               | 2.0%     | 14.1%              | 1.2%         | 2.0%   |           |
| <b>OOF loan</b> |                                  |                                    |                     |          |                    |              |        |           |
|                 | Social Infrastructure & Services | Economic Infrastructure & Services | Transport & Storage | Energy   | Production Sectors | Multi-Sector | Other  | Total     |
| China           | -                                | 2,034.32                           | -                   | 2,034.32 | -                  | -            | -      | 2,034.32  |
| %               | 0.0%                             | 100.0%                             | 0.0%                | 100.0%   | 0.0%               | 0.0%         | 0.0%   |           |
| DAC EU members  | -                                | 316.69                             | -                   | -        | -                  | -            | 34.52  | 351.20    |
| %               | 0.0%                             | 90.2%                              | 0.0%                | 0.0%     | 0.0%               | 0.0%         | 9.8%   |           |
| Multilaterals   | 1,531.81                         | 7,233.65                           | 2,734.08            | 884.84   | 2,174.47           | 954.68       | 792.66 | 12,687.27 |
| %               | 12.1%                            | 57.0%                              | 21.5%               | 7.0%     | 17.1%              | 7.5%         | 6.2%   |           |

(Source: AidData and OECD Stat)

By far, only a bunch of countries have benefited from China's development finance through a small number but large-scale projects. Table 11 lists 10 infrastructure projects in transport and energy financed by Chinese capital as identified by AidData between 2009 and 2014. Bosnia and Serbia are two leading beneficiary countries among Western Balkans states. Considering several big deals signed between China and Bosnia as well as Serbia since 2015<sup>29</sup>, their status as the hub of China's development finance in CEE would continue in the future.

Table 11: Chinese financed transport and energy infrastructure projects, 2009-2014

| Country    | Transport   | Energy   |
|------------|---|--|
| Bosnia     |   | China loans 350 million Euro to Bosnia-Herzegovina for 300MW Power Plant Construction  |
|            |   | China EXIM loans Bosnia-Herzegovina 668 million Euro for 450 MW coal-fired plant       |
| Macedonia  | China EXIM loans 580 million USD for highway projects in Macedonia, implemented by SinoHydro    |  |
| Montenegro | China EXIM Commits 687 million Euro Loan for Construction of Bar-Boljare Motorway in Montenegro |  |
| Serbia     | China loans 216 million USD for the Zemun-Borca bridge  | China loans 300 million USD to construct a thermal power plant                         |
|            | China EXIM loans 204.9 million RMB for container vehicles checking system                       | China EXIM loans phase 1 292 million USD to upgrade the Kostolac thermal power complex |
|            | China EXIM gives 334 million USD loan to the construction of road Corridor XI                   | China loans 608 million USD for phase 2 to revamp Kostolac the coal-fired plant        |

(Source: AidData)

Among three pillars of economic relations between China and CEE countries, the development finance is the most visible and has aroused most anxieties from the EU. EU's reaction is quite understandable, as China, respecting market rules, has brought limited new elements to the current trade and ODI paradigm in CEE. In the words of Vangeli (2017:113),

<sup>29</sup> These deals include the construction of Dabar hydroelectric power plant by CWE, which offered to finance 85% of the project for a total value of 180 million Euro <https://balkanengineer.com/news/chinese-cwe-offer-construction-hydroelectric-power-plant-dabar>, ICBC loans covering 85% of the Construction of TPP Banovici contracted to Dongfang Electric Corporation worth 305 million Euro <https://serbia-energy.eu/bosnia-construction-tpp-banovici-start-2017-commissioning-2021/>, a deal with Sinohydro for the construction of the Banja Luka-Mlinista motorway section <https://seeneews.com/news/bosnias-autoputevi-rs-signs-deal-with-chinese-firm-for-building-62-km-motorway-section-545873>, several commercial and financing deals with China worth a combined 734 million Euro for infrastructure works in Serbia, such as the construction of a section of Corridor XI between Surcin and Obrenovac, the 19.5 kilometre-long section from Ostruznica Bridge to Bubanj Potok, and the first stage of the modernization of the Belgrade-Budapest high-speed railway. [http://www.china-ceec.org/eng/zdogjhz\\_1/t1414696.htm](http://www.china-ceec.org/eng/zdogjhz_1/t1414696.htm)

when facing trade imbalances, Chinese government argues that it is ultimately driven by market forces, and implies that CEE countries need to take their own measures to improve their competitiveness. However, there are very real differences regarding how to use official finance as a tool of development. A key difference is the practice to develop country assistance strategies. As Xu and Carey (2014:107) put it, the existing DAC reporting system has favored grants over loans, softer loans over harder ones, and explicit flows over implicit guarantees. Guided by the principle of one-way altruistic assistance, the DAC has shifted toward social sectors, whereas that may reflect the donors' goals more than those of the country they are assisting. China, on the other side, doesn't have a specific international development agency<sup>30</sup>, reflecting the lack of a coherent country assistance strategy. However, its emphasis on infrastructure and energy suggests that China does not shy away from sharing its own experience and development lessons with CEE countries, that is: "if one wants to develop, one should build the roads first." (Chen, 2016:40). Instead of selling immediate benefits of infrastructural projects, China emphasizes the non-financial added value of infrastructure construction, such as the spatial agglomeration of logistics and production, the increased flow of people and ideas, and its potential to attract more foreign investment. The development finance in transport and energy is therefore considered as a toolkit to improve the trade and ODI relationship with China.

This long-term vision of the derived benefits of infrastructural projects results in the second difference compared with the DAC in the application of conditionality. DAC insists on transparent management, rigorous debt sustainability calculations, and peer review for "best practice" among the DAC members. China argues that large-scale infrastructure transforms economic capacities in a way not captured by current debt sustainability calculations (Xu & Carey, 2015). Moreover, as a latecomer, China claims for a legitimate space to have more flexibility to deploy public finance to fill the gap left by traditional donors in long-term financing such as infrastructure investments (World Bank, 2013:19). Here, China puts forward the "mutual benefits" or "win-win" principle, which is alien to the DAC's North-South welfare/resource transfer concept. In other words, Sino-CEE type South-South cooperation should not be subject to the same set of expectations as Western aid. Correspondently, evaluation standards should take into account mutual benefits. Nevertheless, China is not financing blindly infrastructural projects. With more official finance given, there are signs that China is also taking efforts to monitor and supervise the effectiveness of those projects, such as less tolerance for corruption and mismanagement of resources, and more engagement of Chinese economic expertise (Xu & Carey, 2015). Yet the gap between DAC and China practice is still large.

Another challenge to the smooth development of infrastructural projects financed with Chinese capital in CEE is the active role played by EU funds, whose effect is double fold. In

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<sup>30</sup> At March 13, 2018, China announced its plan to set up an international development cooperation agency. The move is to give full play to foreign aid as a key means of major-country diplomacy, enhance strategic planning and coordination of foreign aid, and better serve the country's overall diplomatic layout and the Belt and Road Initiative. The new agency under the State Council will be responsible for making strategic guidelines, plans and policies on foreign aid; coordinating and making suggestions on major issues related to it; pushing forward reform of the means of aid-giving; making foreign aid plans and overseeing and evaluating their implementation. <http://en.people.cn/n3/2018/0313/c90000-9436375.html>



the first place, in those countries where EU funds are available and sufficient, carrying more burdens of debts is not desirable. In the words of Fürst (2014:83) discussing the attitude of Czech, “The Czech basic concern in economic relations with the PRC is increasing the export flow to China, not to gain credit”. In the second place, EU funds, in financing infrastructural investments, are often connected with the introduction of additional provisions in tender procedures. Moreover, for EU-member CEE countries, EU legislation restricts access to the public procurement market, and imposes restrictions concerning technical standards, equipment, and employment rules. As consequence, those countries which found themselves difficult to attract EU funds, such as Hungary, are trapped in the dilemma to receive China’s concessional or preferential loans under the EU law framework. The illustrating example is the iconic Budapest-Belgrade high-speed railway construction, of which the section in Hungary is postponed by Brussels’s review for potential infringements of the European Union’s requirement that public tenders must be offered for such large-scale infrastructure projects.

Under such context, it is not surprising that majority of China’s financed transport and energy infrastructure projects have been carried out in non-EU-member CEE countries for favorable institutional settings and less demanding regulatory frameworks. Those peripheral states in Europe thus become showroom where China manifests to the EU its capacity and effectiveness to implement such large-scale infrastructure projects as well as their welfare results for the hosting countries, while the EU observes and evaluates the process. Despite some successful stories, Chinese government and companies also paid lessons to adapt themselves to the specific country condition. COVEC’s failure to finish the A2 highway project in Poland reminded China that it would be a mutual learning process. While China introduced a new mentality and way to improve infrastructure in CEE, current EU policies and regulations might exist for some reasons.

In the end, China and EU share the common interest to make less developed CEE countries prosper. In fact, Chinese policy-makers and scholars have called on the EU to make greater investments in infrastructure, in a way that will help to improve interregional discrepancies in Europe (Chen, 2016:43). In response, the EU has also developed a “Balkans Connectivity Agenda” for the countries that are not yet part of the EU. In this sense, China’s move in financing infrastructure projects in Balkan states has obliged the EU to reflex on its longtime negligence about the real need of these countries, and reconsider its strategy of Pan-European integration, especially between EU and non-EU members.

## **Conclusion**

During the decade after the global financial crisis, the economic relationship between China and CEE countries has been enhanced by mutual programmatic interests. Under the 16+1 framework and the OBOR initiative, China envisages to cultivate a type of South-South cooperation with characteristics appropriate for North-South cooperation. The interplay between EU-CEE tradition and China’s innovative approach, therefore, defines current and future features of economic relations between China and CEE countries. The influence of preexistent EU-CEE economic pattern varies among three economic pillars, with the trade

being the least touched, the finance of infrastructure projects being the most conflicting and the ODI pattern being the best example of mutual impacts.

In the first place, CEE countries' trade with the whole world, including that with China, has been largely shaped by their different degree of integration into the global production networks through the investment of European multinationals. In general term, we may distinguish those countries deeply integrated into European industry system from those that less integrated into the global value chain. China' trade with the first group of countries, determined by its own position in the global value chain, represents the most of its trade with the CEE region, and characterized by a high concentration in medium and high technology industry intermediaries. In the meantime, its trade with the second group of countries marks a clear one-way inter-industry trade and increasing imports of lower value-added primary goods and resource-based manufactures. In the second place, the investment pattern of European companies in CEE countries could be perfectly explained by mainstream FDI theories. The efficiency-seeking and the market-seeking motivations are the dominant drivers, while fundamental economic indicators and the quality of institutional environment are the most powerful factors to determine the location of their investment. On the other side, Chinese investors, which are prematurely internationalized companies that are not necessarily the business leaders in the world, have a strong strategic-asset-seeking motivation. Given the spatial concentration of European ODI in CEE and the positive local technological spillover, this type of Chinese ODI is also lured to traditional attractive FDI destinations within CEE. In the meantime, there exists a long-lasting market-seeking motivation, but the market Chinese investor seek is not limited to local or regional market, but the EU single market. The consideration to gain a strategic entry point to wider Western European markets weakens the correlation between the economic size of hosting country and China's ODI. Moreover, the acceleration of China's ODI in CEE is led by large-size companies. Lack of internationalization experience, these new players intent to choose M&A as less risky entry mode, which in turn makes them more dependent on personal networks or bilateral political connections where the government serves as the mediator. In this context, the soundness of impartial institutional environment of hosting country becomes secondary. In the last place, China's mentality to use official finance as a tool to improve infrastructure projects contrasts European concept. The contrast could be summarized as win-win spirit against one-way welfare transfer, the opaque negation against transparent management, and the flexible requirements against strict standards. The conflicts, on the one hand, make most of Chinese financed infrastructure projects concentrated in Western Balkan states, which are not yet EU member; on the other hand, impose barriers to China's intention to extend this model to the rest of CEE countries, exacerbating the tensions already existed between the European Commission and certain countries, such as Hungary.

By far, from the perspective of interest stocks of China in CEE, China's economic exchange with the most important economies in the region falls into EU framework, which suggests that the state's potential and its economic structure are the basic reason of the strength of bilateral economic relation (Góralczyk, 2017:158; Fürst, 2014:86). However, from the perspective of interest flows, China's importance has been significantly increased in

smaller peripheral states, which might help to alleviate economic inequalities within the region. The different effects of Chinese economic engagement on individual countries, which might not be deliberately designed by Chinese authority, signify the heterogeneity in terms of political culture, history, and relation with the EU among CEE countries. In this context, the challenge to the 16+1 framework is the lack of a uniform policy towards the region's states as a whole from Chinese part, and the lack of shared goals among CEE partners which treat each other as competitors. As emphasized by Vangeli (2017:104), the main innovative nature of the 16+1 framework is that China defines the regional makeup composed of the countries which have never come together to form a single political community. Despite all the efforts committed by participants, for the moment, the 16+1 framework is still characterized by fragmented interests at the practice level, making many observers believe that China has been using this partly superficial multilateral format to improve its long-term bilateral relations with selected states in the region, risking thus Europe's unity. Nevertheless, according to our analysis, the debate in which the 16+1 and OBOR initiatives are framed in terms of the threat they pose to European unity should be treated as exaggerated. The fear and doubt that the 'old' European Union cast on 16+1 and OBOR is by large triggered by China's unique approach to realize infrastructure projects through official loans. But this fear and doubt could also be rooted in distrust and misunderstanding of China's intent. As an experiment without a pre-established blueprint, the OBOR initiative is subject to the constant modification, just as all reform policies carried in China used to be. During this learning process, it is critical for both parties to keep an open mind, maintain dialogue, and seek the mutual adjustment. In the end, the European unity and the EU's cooperation are critical for the implementation of the OBOR initiative, as no matter how many roads and bridges would be constructed, without Europe's participation, they will lead to nowhere.

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