Institutional Perspective and Political Economic Analysis of Chinese Economic Engagement in CEE[1] within the EU Framework

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After the profound international political and economic change followed by financial crisis, the global power has shifted gradually from the West to the East. The rise of global protectionism, unilateralism and nationalism led by the US is constantly challenging the existing international systems. As a new rising power, China has made proactive efforts to exert its role in the international arena, and has started to show its ambitions in international relations with the "Belt and Road Initiative" in 2013, aiming to build the connectivity between China and Europe, two great players in global economy.

In 2012, China took the initiative to establish the economic cooperation with Central and Eastern European (CEE) countries under "16+1" framework, as a sub-strategy of Belt and Road Initiative, which provoked a heated debate among Europe. The co-existence of economic interests and political concerns from China's engagement in CEECs lead to the different responses from the EU member states. The questions remain that what are the responses from the EU institutions and its implications for the further China's economic cooperation with the CEE.

1. Introduction

In 2012, "16+1" institutional cooperation was established in Warsaw to deepen the relation between China and the 16 CEE countries, which is integrated as a part of the BRI (Belt & Road Initiative). With the close political ties between China and CEE countries, more investments and construction projects were delivered in this region. Chinese engagement in CEE has aroused heated debates from both academic and political fields about whether it is compatible or in clash with the EU interests. Furthermore, as Chinese MNCs have conducted remarkable number of M&A deals in the key sectors such as technology and infrastructure, it provoked great concerns among the political observers and policymakers.

As the deepest integration actor in the world so far, the CEE member states still show great economic dependence on Western EU members, and member states are still facing EU instit-

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

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utional constraints when dealing with the third countries (Zhang, 2018). Therefore, the trans-regional cooperation is faced up with a dilemma during the implementation. The investment growth didn't sustain even though the China-CEE political ties have entered the best period. This paper aims to study how the EU responds towards the China-CEE cooperation and what are the implications for Chinese investments in this region with special focus on the infrastructure construction and foreign investments from institutional and political economic perspective.

2. Patterns and Motivations of Chinese Economic Engagement in CEE

Plenty of researches reveal different opinions of scholars and experts on the motivations in which factors drive the Chinese investment in CEE countries. The push and pull factors of China-CEE cooperation will be collected and summarized based on the literature review from both Chinese and Western scholars.

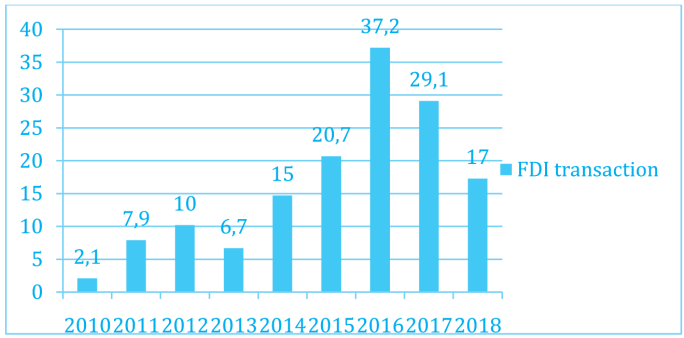
Firstly, the policy of "going global" put forward by Chinese government in 2000, encouraging Chinese domestic firms to engage in the overseas investment to obtain the maximum profits and improve its competitiveness (Szunomar, 2016). With such a strategic orientation, China pushed state-owned and private companies to pursue the overseas investment opportunities, making China a major capital-exporter. What's more, the fast-growing economy and large foreign exchange reserve are supporting China to invest in the EU (Fan, 2014). In addition, the commercial motivations also push China to engage in the Europe in order to acquire technology, know-how, and brands and circumvent the trade barriers (Wade, 2014). In recent years, the project B&R initiative and '16+1' framework have enhanced the bilateral cooperation between China and CEE.

From the perspective of CEE countries, they provide incentives for FDI via tax-concession, tariffs-abolition, the settlement of free economic zones, and the avoidance of double taxation (Haico et al, 2010). What's more, other opinions especially from Western European countries are that China is transferring their politics and values via economic cooperation. More than two third of Chinese outward FDI in Europe comes from state-owned enterprises, which links to political goals instead of economic interests (Davis et al, 2016).

The Chinese investment in the EU has a dramatic growth in the last decades from less than 5,000 million USD in 2008 to 70,000 million USD in 2017, with the takeovers in the EU reached a record volume of approximately EUR 20 billion (MOFCOM, 2017). In terms of investment mode, 94% of the total investments are conducted through acquisition (Rhodium group, 2017).

And the annual value of completed Chinese FDI transactions in the EU increased to 37.2 billion EUR in 2016, which is more than 15 times of it in 2010. However, it has declined after 2016 (see figure 1) as a result of capital control from Chinese government and tighter scrutiny of foreign investment throughout the EU.

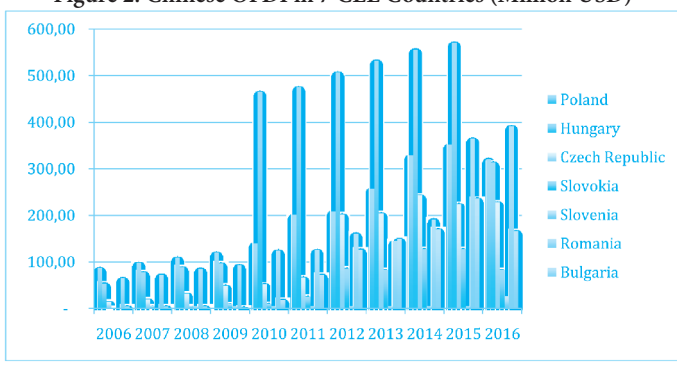
Figure 1. Annual value of completed Chinese FDI transactions in the EU-28, EUR billion



Source: Rhodium group, 2019

Meanwhile, recent years have seen an increase of Chinese FDI in the CEE countries. The figure 2 shows the investment trend from China to CEE-7 countries with total volume from 227 million USD in 2006 to 1530 million USD in 2016 (MOFCOM, 2018), and Hungary is the top destination for Chinese FDI among others. It is worth mentioning that there are huge data differences from different data sources such as OECD, Eurostata. Chinese investment in this region is driven by favorable economic environment, institutional stability, and EU single markets (Szunomár, 2014).

Figure 2. Chinese OFDI in 7 CEE Countries (Million USD)



Source: MOFCOM, 2018

Regarding to the sectoral distribution, Chinese investment fields involve transport, energy, tourism and housing estate etc., ICT, transport, utilities and infrastructure have become the top sectors for Chinese investment in Europe in 2017 (Rhodium group, 2017).

3. EU Responses toward Chinese Investment

According to the speeches of government officials, European diplomats believed that Chinese government needs international support for the hot territorial issues such as the dispute on South China Sea, Taiwan and Tibet. For example, Hungary and Greece refused to criticize Chi-

na, and some countries which are also faced up the maritime issues didn't express strong stand on South China Sea issue (Emmott, 2016).

The voice from government officials reveals the intense criticism from Western EU countries. Sigmar Gabriel, the German vice-chancellor and foreign minister, called on Beijing to respect the concept of "one Europe" adding that if Europe doesn't develop a common strategy towards China, then China will divide Europe (Yuriy, 2017). Junker (2017) has mentioned that *Europe must put forward a new framework for investment screening. If a foreign, state-owned, company wants to purchase a European harbour, part of our energy infrastructure or a defence technology firm, this should only happen in transparency, with scrutiny and debate. It is a political responsibility to know what is going on in our own backyard so that we can protect our collective security if needed.*

From the perspectives of institutional rules, it seems that the EU also takes actions towards Chinese economic engagement. The term "EU institutions" in this paper has a broader scope that refers to the EU institutional body, EU institutional regulations, rules and norms. EU member states have shifted their trade policies to the supranational level. However, the foreign investment policies are scattered over both national and supranational level. According to Lisbon Treaty, the EU commission has the competence to negotiate bilateral investment treaties (BITs) with a third country in order to regulate the inward FDI to the member states and protect the European outward FDI (Meunier, 2014). Member states respectively hold the BITs with China until an EU level bilateral investment treaty is achieved (European Commission, 2013). Nevertheless, the EU can use the competition policy[3] and common commercial policies to influence Chinese economic engagement in the CEE countries regarding to investment projects especially in public security and infrastructure fields (Grieger, 2017).

Lots of Chinese infrastructure investments can be hardly delivered due to the potential violation of the EU competition rules, and public procurement etc.. For example, the project of the railway between Budapest and Belgrade is currently under investigation because Brussels suspects it may violate EU bidding laws due to lack of transparency (Kynge & Pee, 2017). Another Chinese investment project to building motorway A2 in Poland failed after Chinese Overseas Engineer Group Co (COVEC) won the tender with the lowest price. One of the important reasons is that the investment project failed to comply with the EU regulation such as labor standards and migration law etc. (Jin. 2015). Lack of the knowledge about the EU rules and regulations is also a big challenge for Chinese investments in the European markets.

What's more, an important moment is that the key players such as Germany, France call on a tighter scrutiny for foreign direct investment regarding to the national security issues and strategic assets especially when state-owned enterprises are involved. And EU commission passed a bill to establish a common screening framework in 2017 and it will take effect in April, 2019. Under the new foreign investment screening mechanism, the member states can further identify the potential security threats posed by foreign acquisitions in the key sectors such as infrastructure and technology (European Commission, 2017). The table shows the recent change of national-level screening

[3] Common competition policy refers to the *essential tool to the achievement and maintenance of the single market. It ensures the competitive conduct of undertakings (firms, companies, businesses) and protects the interests of consumers by enabling them to procure goods and services on the best terms. It promotes economic efficiency by creating a climate favourable to innovation and technical progress*

framework since 2017 in some member states. The big member states such as France and Germany expand the scope for defining the critical sectors related to security concerns and strengthen their control for foreign acquisition. Czech Republic started to consider setting this mechanism. However, Hungary established it in 2018 to respond the EU's proposal (Hanemann et al, 2019).

Table 3. National-level screening mechanisms and changes sin

Regime in place but no change | Regime in place and updated | No regime

Newly established regime | No regime but considering change

Country	Year of Change	Recent change
Germany	2017/2018	Broader control of foreign takeovers on critical infrastructure and strict investment screening rules to review acquisition from non-European foreign companies with over 10 percent of a German firm in the key sectors such as: defense, critical infrastructures and the media.
France	2018	Expansion of the list of sensitive sectors that foreign investments are to be reviewed and approved by Ministry of Economy including cyber security, artificial intelligence, robotics and semiconductors etc..
Poland		Apart from the specific sectors, foreign investor planning to buy more than 20% of strategic companies need to be approved by Minister of State treasure
Czech Republic		Considering setting up a investment screening mechanism
Hungary	2018/2019	Newly established regulation of approval from government for investing companies with non-EU shareholders in acquiring assets in national securities,
Bulgaria / Croatia Slovokia / Slovenia		
Latvia	2017	Strengthening its investment policy concerning national security, establishing a mandatory review mechanism for transfer of ownership in companies in national and European critical infrastructures.

Source: MERICS and Rhodium Group research, 2019

4. Case Studies

Two case studies about Chinese engagement in Hungary are elaborated in this paper to explore to what extent the EU institutions can affect the implementation of Chinese investment projects. One case is Budapest–Belgrade railway and another case is Huawei Technologies Co, Ltd, which represent the infrastructure and technologic sectors. However, compared with Huawei, it is worth mentioning that Budapest-Belgrade railway is not a foreign investment but a loan-based construction which is financed by Chinese credits. The loan-based infrastructure construction has concerned the EU regarding to the debt diplomacy issues between China and the CEE members.

We also adopted political economic approach to provide more comprehensive about the EU's responses towards Chinese economic engagement especially investment in CEE regions besides the institutional perspectives based on several reasons: First of all, the attitudes towards new rising power from the Western countries are complicated which might include the regulative constraints as well as ideological and political concerns, since Chinese presence has always been a hot issue in international political economic field. Economic nationalism can be used as the theory in this article to explain why host countries, or especially the EU tries to limit the influence of foreign investors for the good of domestic economic actors (Gilpin, 1975). Besides, the host governments tend to adopt the political, bureaucratic and institutional factors to limit the foreign companies in order to win more support from nationalists (Krugman, 1987).

4.1 Budapest-Belgrade Railway

The around 350km long Budapest-Belgrade railway is the pilot project under the "16+1" platform, which connects the capitals between Hungary and Serbia. The infrastructure project is part of China's Belt and Road Initiative by linking the Greek Port of Piraeus with other European cities as the map shows. The project is financed by Chinese Export-Import bank with 3 billion USD loans at 2-3 % of interest rate (Ferchen et al, 2018). The Hungarian section of the railway takes USD 2.1 billion, of which 85% financed by Chinese EXIM Bank with 20-year loan base. Chinese-Hungarian Railway Non-profit Ltd co-organized by China Railway Group and Hungarian Railways (MÁV) is responsible for the projects (Suokas 2017).

This project was officially put in agreements among the three parties in 2014 and expected to be completed in 2023[4]. However, the project on the Hungarian side has been suspended while the Serbian parts of the project started according to the agreements. The suspension of the Budapest section of the railway project partially attributes to the investigations from the EU commission in terms of procurement, bidding laws even anti-corruption regulation (Liu, 2017). From the perspective of the EU, it is believed that this project implies geoeconomic and geopolitical goals based on several reasons: this infrastructure project has been symbolized as China's political leverage within the EU through economic means, and policy makers and think tank in Europe thinks that the railway cooperation with China is part of political goals for Orban government to build its illiberal democratic system in Hungary[5], which will harm the EU norms and values. Second, based on the political economic approach, the infrastructure construction in the CEE countries is mainly financed by the EU structural fund and then contracted to the Western companies (Oehler-Şinca et al. 2017). However, Chinese presence in the CEE infrastructure market will potentially harm the EU economic interests. For example, the increasing number of Chinese infrastructure projects in non-EU CEE countries attracts the attention from the Western EU and "Berlin process" was launched by the EU under the EU's Connectivity Agenda for the Western Balkans (EU parliament, 2018).

And the EU institution voiced Chinese concessional loans are not favourable and competitive compared with the EU funds with 2-3 percentage of interest rate which aroused criticism from scholars and other officials (Chen, 2018). The debt-financed projects will put the small economies vulnerable towards the fiscal instabilities in Balkan countries. Based on the constraints from the EU institutional rules, many Chinese infrastructure investments can't be delivered as expected even with the close political and economic ties between China and CEE countries (Eder et al, 2018).

4.2 Huawei in Hungary

The IT giant company of China, Huawei, established its representative office in 2005 with 1.2 billion dollars and then built its distribution centre in Budapest in 2009. It has achieved great success since its arrival and over 70 percent of the Hungarian population has used its mobile telecommunication equipment and services [6]. The Hungarian government signed a strategic partnership agreement with Huawei in 2013 and MOU of building a 5G network infrastructure in 2018[7]. However, it has been a hot topic in Western countries concerning national security issues. Currently the US has charged the company for several suspected crimes such as technology theft from T-mobile and violation of the sanction on Iran. Besides, the US has call on other allies such as the European countries to take measures to hinder the development of Huawei 5G network, which creates great trouble for Huawei in other host countries for its 5G developments in spite of lack of evidence for the charge.

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[4] "The Belgrade Guidelines for Cooperation between China and Central and Eastern European Countries," Ministry of Foreign Affairs, December 17, 2014

[5] Benner et al., "Authoritarian Advance: Responding to China's Growing Political Influence in Europe."

[6] US ups pressure on Europe over 5G infrastructure from China's Huawei, 2019. Available at: https://phys.org/news/2019-03-ups-pressure-europe-5g-infrastructure.html

[7] http://abouthungary.hu/news-in-brief/huawei-signs-hungarian-government-mou-for-building-5g-infrastructure/

After the political backlashes against Huawei from Australia, the USA and Canada, the attitudes within the EU are less aggressive and more divided. Under the pressure of the US, German Chancellor Angela Merkel responds *"Security, particularly when it comes to the expansion of the 5G network, but also elsewhere in the digital area, is a very important concern for the German government, so we are defining our standards for ourselves, We will also discuss these questions with our partners in Europe, as well as the appropriate offices in the United States."*(Sourav, 2019). The Western big EU members are more cautious and tighten their regulations based on a rule-based approach. Poland and Czech Republic are more objective towards Huawei (Patricolo, 2018). In particular, the EU has put the relevant issues specific to the key investment sectors related to critical infrastructure and national security into the new framework in the documents[8]. The Actions 9 and 10 below are quite relevant for Chinese investment and mention 5G network without actually indicating Huawei. However, as one of the best telecommunication companies, Huawei has a leading and ground-breaking innovation of 5G networks and aims to provide the world with better internet service.

Action 9: *To safeguard against potential serious security implications for critical digital infrastructure, a common EU approach to the security of 5G networks is needed. To kick start this, the European Commission will issue a Recommendation following the European Council.*

Action 10: *To detect and raise awareness of security risks posed by foreign investment in critical assets, technologies and infrastructure, Member States should ensure the swift, full and effective implementation of the Regulation on screening of foreign direct investment* (EU commission, 2019).

However, Hungarian government provides a stable and friendly environment for the future development of this Chinese company by supporting its 5G network in Hungary disregarding the warning from the USA[9]. The success of Huawei in Hungary is part of Orban's "East Opening Policy" and Hungarian government wouldn't take a risk to destroy the current political relations with China by curbing Huawei 5G application.

5. Conclusion

To some extent, China's investment in Europe took the window opportunity of the Euro crisis but it has a long term strategic cooperation under the BRI and "16+1" platform. And bilateral cooperation between China and CEE countries provoked anxiety and tension among the EU because they believe the institutionalized cooperation between these two parties will make it harder for EU member states to achieve common China policy. Meanwhile, the EU institution can restrain the national policy choices toward a third country from political, economic and institutional perspectives (Jin, 2015). The future trend of Chinese investments in the EU will be affected based on the big share of acquisition economic activities and relevant sectors covered by the investment screening procedures. As for Chinese engagement in the CEE especially in Hungary, the infrastructure construction will be under the watch from the EU institutional rules and the implementation process can be delayed or even suspended. However, the individual member states are more decisive in implementing the investment screening framework when dealing with the foreign investments. Due to the good political

[8] *"European Commission contribution to the European Council EU-China – A strategic outlook"*

[9] Sherisse Pham, (2019): The US is stepping up pressure on Europe to ditch Huawei. CNN business. Available at:https://edition.cnn.com/2019/02/11/tech/huawei-mike-pompeo-hungary/index.html

relations, Hungary will continue to support current Chinese investments or infrastructure project and attract more Chinese investments. However, Hungarian government can use the framework and the EU institutional rules as a leverage to introduce more Greenfield investments instead of acquisition activities for its own benefits since the investment screening procedure targets at M&A and Hungary lacks for the key technology for Chinese investment to acquire.

The future negotiation of ongoing bilateral investment treaty between the EU and China is quite important for the China-CEE cooperation where the EU member states should achieve a common ground toward Chinese investment. However, there are a lot of requirements and standards which put the Chinese side in disadvantage when it comes to market access. The Chinese government will probably have to make a concession in order to achieve the treaties. Besides, there are a lot of tools that the EU can adopt to restrict Chinese FDI in Europe and the US has already taken measures to control Chinese national companies under the claim of national security, fair market access and technological transfers etc. (Zhang, 2018). In such a context of global situation, the uncertainties and challenges increase further for the future Chinese economic engagement in CEE countries. The EU should deal with Chinese investment objectively and rationally to avoid the same political backlashes against China which will further lead to global protectionism.

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