China, the 16+1 format and the EU

SUMMARY
Since 2012, China has engaged 16 central and eastern European countries (CEECs), including 11 EU Member States and five Western Balkan countries under the 16+1 cooperation format, which it has portrayed as an innovative approach to regional cooperation. Although framed as multilateralism, in practice this format has remained largely bilateral and highly competitive in nature.

While in 2012 the CEECs had enthusiastically embraced this form of cooperation as a chance to diversify their EU-focused economic relations in the wake of the 2008 financial crisis, by 2018 some of them had voiced dissatisfaction with the economic results it had yielded for them. The 2018 Sofia summit guidelines for the first time stressed the need for a more balanced trade, reciprocity of market access and open tenders in infrastructure construction, thus echoing concerns the EU had repeatedly raised with China.

Empirical evidence shows that China-CEEC trade had actually jumped prior to 2012, whereas afterwards it increased at a much slower pace, with Chinese exports to CEECs expanding much quicker than CEEC exports to China, thus generating an unbalanced trade that is heavily tilted in favour of China. Foreign direct investment (FDI) data reveal that while Chinese FDI is highly concentrated on the biggest CEECs, it accounts for an extremely low share of total FDI stock. Some smaller CEECs have started to attract Chinese FDI as well, although at comparatively low levels. Some of China's infrastructure construction projects in the CEECs have suffered setbacks in a regional environment governed by EU norms and regulations.

The EU engages in the 16+1 as a summit observer, adheres to the principles of its 2016 strategy for China and works towards cooperation with China on physical and digital infrastructure through the EU-China Connectivity Platform. It has added the Berlin Process to its Western Balkans policy and has issued a new strategy providing for a credible enlargement perspective for and an enhanced EU engagement with the Western Balkans.

This updates an ‘at a glance’ note, China, the 16+1 cooperation format and the EU, of March 2017.

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China's vision for regional cooperation and the 16+1 format

In 2012, in the wake of the 2008 financial crisis and the low-growth environment in the EU, China set up a cooperation format with 16 CEECs which share a communist past but are otherwise fairly heterogeneous in terms of their economic development and legal status as EU Member States and (potential) candidates for EU membership. China values their geostrategic position as a bridgehead to the EU market and a crucial transit corridor for its Belt and Road initiative (BRI).

Since the 16+1 format's creation, one of the main issues has been how it will impact on EU-China relations and the EU's internal political dynamics. It has provided arguments to those perceiving the format as a threat – notably to the EU’s political unity and normative influence on the CEECs, including risks of a reversal of the EU's reform agenda in the Western Balkans – and to those believing in the opportunities the format may provide for CEECs to accelerate the process of catching up in their economic development with the 'old' EU Member States.

The 16+1 format follows a China-defined experimental and innovative approach to regional cooperation, which shares common features with the other multilateral cooperation platforms China has created with African, east Asian, Latin American and Middle East countries to introduce a new type of non-Western 'South-South' multilateralism. These features include

- a Chinese normative basis consisting of principles such as consensus-based decision-making, inclusiveness, non-conditionality, voluntarism, and win-win results,
- context-dependent flexible shifts between multilateral venues for dialogues on the regional agenda and, usually, bilateral project-based implementation, with multilateralism not seen as an aim, but rather as a tool to enhance bilateral ties, which remain instrumental,
- a loose, incrementally expanding institutionalisation pattern, including multi-level gatherings and sectoral coordination mechanisms,
- a China-centred agenda-setting, which, despite the inherent power asymmetry in favour of China, may be challenged by China's counterparts based on the Chinese normative basis of equality, consensus and mutual agreement, and
- Chinese 'no strings attached' financing tools that usually take the form of concessional loans from Chinese policy banks (such as the Chinese Development Bank (CDB) or China Export-Import Bank (Exim Bank)), or more recently funding derived from Chinese or joint investment funds.

Whether the respective cooperation format moves beyond 'nominal' multilateralism appears to depend on the regional context and the political willingness, resources and capabilities of the local counterparts to join forces and actively shape the agenda according to their own interests. Given the CEECs' advanced stage of development, the 16+1 format, which covers trade and investments, transport connectivity, finance, agriculture, science and technology, health, education and culture, has evolved in a slightly different way from other China-led regional platforms:

- higher frequency of 16+1 summits and lower-level gatherings; past yearly annual summits were held in Warsaw (2012), Bucharest (2013), Belgrade (2014), Suzhou (2015), Riga (2016), Budapest (2017) and Sofia (2018), however the 2018 Sofia summit took place only eight months after the 2017 Budapest summit, shortly before the 20th EU-China summit in July 2018,
- local cooperation between CEECs and Chinese cities and provinces intended to compensate for the asymmetry in market size between China and CEECs,
- the institutionalisation process of sectoral coordination is not China-centred, but each mechanism covers a specific sector and is led by a CEEC on a voluntary basis, potentially providing more space for genuine, not only 'nominal' multilateralism,
- the 16+1 format is a key platform for promoting the Belt and Road Initiative; CEECs are incorporated into the BRI based on their specialisation (e.g. Estonia: e-commerce).
The 16+1 format in 2018: still work in progress

Gradual institutionalisation and policy adjustments

Judging from recent research and the Sofia summit guidelines of July 2018, all CEECs but Albania and Estonia have set up sectoral coordination mechanisms on a broad range of themes, such as maritime issues (Poland), energy (Romania) or forestry (Slovenia), or have committed to doing so (Bosnia and Herzegovina: veterinary science; Croatia: SMEs; Lithuania: financial technologies; Macedonia: culture; and Montenegro: environmental protection). Due to the recent establishment of these mechanisms, there is as yet no empirical evidence that this multi-sector institutional expansion has yielded sufficient economic gains to offset the sizeable costs involved in maintaining the frequency of meetings, notably for small CEECs. Yet, enthusiasm on this front seems unabated.

According to a 2017 Chinese government think-tank review of the past five years of the 16+1 format's operation, the frequency of multi-level and sector-specific meetings and consultations has increased, thus upgrading a previously 'weak' partnership and creating a new CEEC 'growth pole'. In line with this view, the 16+1 format has provided numerous opportunities for CEECs to engage with Chinese counterparts and among themselves that they would not have enjoyed without the format's existence. Hence, China sees the format's creation as a gap that it has filled while pursuing its national interests. Seen through China's lens, the format's achievements include, among other things, a higher number of strategic partnerships with CEECs (the Czech Republic, Hungary, Poland and Serbia), city and province partnerships, direct flights, and China-Europe-Express connections. The latter are based on existing rail links and are still largely driven by Chinese subsidies.

In response to external criticism regarding the format lending itself to the pursuit of 'divide and rule tactics' and thus to the detriment of EU unity, the number of summit observers (Austria, Belarus, the European Bank for Reconstruction and Development (EBRD), the EU, Greece and Switzerland) has gradually increased. Summit guidelines have come to highlight that the 16+1 cooperation format is a complement rather than an alternative to the EU-China comprehensive strategic partnership. There has also been a push for website-building to enhance the format's transparency, since currently information on the 16+1 activities beyond the summit guidelines is extremely sparse. This hardly allows for a comparison between summit rhetoric and the reality on the ground.

CEECs' cooperation intensity in the 16+1 format and attitudes towards the EU

The 16+1 format is an attractive tool for China to increase its political influence on CEECs, as it is one of China's main platforms to push its BRI vision forward. Since the BRI raises high expectations with CEECs for future Chinese investment and funding, the 16+1 format allows China to mould CEECs into political allies willing to support Chinese core interests at EU level. In recent years, some CEECs have in some instances given priority to Chinese political interests over EU interests. By holding dissenting positions on the South China Sea issue, the situation of human rights (lawyers) in China, the BRI, the market economy status issue and a potential EU-level FDI screening mechanism, some CEECs have used the 16+1 format as a bargaining chip within the EU and may have raised their profile in competition with other CEECs, in order to curry favour with China.

The correlation between the CEECs' cooperation intensity in the 16+1 format, measured against the pace and scale of their implementation of initiatives and their positioning towards the EU, has recently been the subject of research that classifies the CEECs into four groups (see Table 1). The research found that higher levels of cooperation intensity were correlated with negative attitudes towards the EU, higher importance attached to national interests, and efforts to link up with a global player like China and/or Russia to balance the EU. Lower levels of cooperation intensity corresponded to euro-optimist/euro-moderate stances, strong dependence on the EU internal market or political inertia. The research also suggests that a higher degree of dependence on EU trade and FDI as well as funds (which is higher for the EU-11 than for the Western Balkan countries), did not necessarily guarantee positive attitudes towards the EU. During the 2014-2020 funding
period, CEECs identified by the research as ‘euro-sceptic’ have been getting the lion’s share of EU funds (€128 billion to €190 billion). Conversely, Chinese initiatives have not automatically led to positive attitudes towards China among the citizens of CEECs, notably in the ‘euro-sceptic’ CEECs. It remains to be seen how these dynamics will unfold under the new EU multiannual financial framework, which analysts warn may make Chinese offers even more attractive, and fuel dissenting attitudes among CEECs, if receiving EU funding is linked to compliance with rule-of-law principles.

Table 1: CEECs’ cooperation intensity in the 16+1 format and position as regards the EU

<table>
<thead>
<tr>
<th>Cooperation intensity in the 16+1 format</th>
<th>Country</th>
<th>Position towards the EU</th>
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</thead>
<tbody>
<tr>
<td>Active participants (‘champions’, ‘leaders’)</td>
<td>Czech Republic, Hungary, Poland, and Serbia</td>
<td>All are euro-sceptic and all are China’s strategic partners</td>
</tr>
<tr>
<td>Ambitious partners</td>
<td>Bulgaria, Latvia, FYR Macedonia, Romania and Slovenia</td>
<td>Most are euro-optimists/euro-moderates (Bulgaria is euro-sceptic)</td>
</tr>
<tr>
<td>Followers</td>
<td>Croatia, Estonia, Lithuania and Slovakia</td>
<td>Euro-optimists/euro-moderates</td>
</tr>
<tr>
<td>Laggards</td>
<td>Albania, Bosnia-Herzegovina and Montenegro</td>
<td>Euro-optimists/euro-moderates</td>
</tr>
</tbody>
</table>


China’s growing political influence on CEC policy-makers, businesses, media, civil society and academia has received increasing media coverage and has become a topic of academic research. Chinfluence is a new initiative dedicated to analysing the Chinese impact in the region, mirroring similar research undertaken by think-tanks in EU Member States not part of the 16+1 format.

**CEECS' short-term economic goals versus China's long-term strategic vision**

Six years after the 16+1 format’s creation, there is a growing mismatch between the high expectations of some CEECs for economic outcomes, nourished by China’s summit rhetoric, and actual achievements. Outcomes are either heavily tilted in favour of China or their limits are in line with China’s long-term (geo-)political and economic agenda linked to the development of the BRI. Unsatisfactory economic outcomes for the CEECs may not merely be due to the obvious asymmetry in market size, but also to trade and investment barriers: according to the European Commission’s market barriers database, China has 25 of these, in second place only to Russia (34). Such results have given rise to disappointment and scepticism even among major CEECs such as Poland, which runs the highest trade deficit with China, although countries like Romania have remained firmly positive, as have the Baltic countries. The latter have never had unrealistic expectations.

The Sofia summit appears to have marked a turning-point in CECs’ behaviour and a shift away from a scenario where China sets the agenda alone and CEECs merely endorse it. For the first time, the summit guidelines contained indirect CEC criticism of China’s approach as regards the format’s resource-intensive mode of cooperation and the lack of tangible economic results for CEECs. This is compounded by the reference to concerns continuously voiced at EU level, such as the lack of reciprocal market access for CEEC companies in China or a level playing field between CEEC and Chinese companies in China or open and transparent tenders, and the need for China to accede to the WTO Agreement on Government Procurement (GPA) as announced back in 2001.

Ahead of the Sofia summit, an increasingly unfavourable geopolitical environment, including escalating trade tensions with the USA, may have prompted China to seek to dissipate concerns about the format by proposing to involve Germany in it and by spreading rumours about a change of the frequency of 16+1 summits to every two years.
China-CEEC trade in goods

Trade in goods reached €57.3 billion in 2017, a small amount compared to the total EU-China trade of €573 billion and falling far short of the initial aim to reach US$100 billion by 2015. Between 2012 and 2017, China-CEEC trade in goods increased only by €7 billion, at a much slower pace than during the three preceding years, when it grew by €20 billion. The trade balance is heavily tilted in favour of China, whose exports to the CEECs grew much quicker than imports from them. Figure 1 shows that China-CEEC trade is largely concentrated on the four Visegrád countries and Romania. The EU remains the Western Balkan countries’ top trading partner (with a trade volume of €47.5 billion, accounting for 72.8% of overall trade); China meanwhile ranks second with €3.7 billion (5.7%).

As for the composition of trade in 2014, about 50% of Chinese exports to the CEECs were machines and electronics, followed by textiles and metals and metal products. The picture is more diversified for CEEC exports to China, as most EU-11 export machines and electronics to China, with the exception of Bulgaria, where commodities made up 71% of main exports. Slovakia stands out, with cars and car parts accounting for 76% of exports. By contrast, Western Balkan exports to China are focused on commodities: For example, Albania has a focus on chromium ore, FYR Macedonia on ferroalloys and Serbia on iron ore. China’s share in trade with the Western Balkans is higher (e.g. Montenegro: 8.6%) than in trade with the EU-11 (e.g. Croatia: 2.1%).

China’s investment pattern and FDI stock in the CEECs

China’s investments are primarily guided by its interest in pushing forward with its BRI in the region to better connect to the EU market through new intermodal transport channels as time- and cost-saving alternatives to existing longer ones. Hence, transport and energy investment and infrastructure construction have been China’s priorities for the CEECs. This dovetails with the CEECs’ interest in tackling their transport and energy infrastructure deficiencies. A 2017 IMF report on the infrastructure gap in the Western Balkans states that at present annual public investment rates, it would take the region about 33 years to catch up with the EU level of capital stock per capita.

As for the entry mode of FDI, since 2011 Chinese greenfield investment has decreased in favour of acquisitions and has been more common in the EU-11 than in the Western Balkan countries. However, as wages have risen significantly in China but have remained comparatively low in the CEECs, this has created incentives for China to relocate production to the EU’s periphery, which may serve increasingly as an assembly base of products for the EU markets (known as tariff-jumping FDI).

In the manufacturing and services sectors, China’s market-seeking and efficiency-seeking motives have led to both greenfield investment (e.g. Hungary: BYD, electric buses; Serbia: Mei Ta Group, engines and car parts; Huawei and ZTE in several CEECs) and acquisitions (e.g. Poland: China Everbright International, municipal waste processing; Slovenia: TAM Durabas, Hisense, household appliances). In the transport and energy sectors, China’s resource-seeking and strategic asset-seeking motives have translated into acquisitions (e.g. the Tirana Airport in Albania and Maribor Airport in Slovenia; and major oil fields in Albania). While the Chinese acquisition of the Železara
Smederevo steel mill in Serbia seems to be a success story, the joint venture of Chinese Great Wall Motors and Bulgarian Litex was not, as it filed for bankruptcy (however, a new EU investor has been found). Most recently, the acquisition of Romanian oil company Rompetrol by the Chinese energy firm CEFC has been cancelled.

Contrary to China’s recent investment push into the ‘old’ EU Member States, Chinese investment in the CEECs has been much more moderate and, particularly in the Western Balkans, has frequently taken the form of loans for transport and energy infrastructure construction rather than FDI.

Figure 2 shows that Chinese FDI stock is concentrated in the bigger EU-11 (left graph). Smaller CEECs have received significantly lower levels of Chinese FDI (right graph). Serbia is the only Western Balkan country to have attracted sizeable FDI from China. Until 2015, Hungary was the leading FDI recipient, ahead of Poland and Romania, given its close political ties with China based on its position as a frontrunner in accommodating Chinese interests and its large Chinese diaspora. However, after the Czech Republic’s diplomatic U-turn, spearheaded by President Miloš Zeman after his election in 2013 (the country shifted from being China’s biggest critic among CEECs to one of its most vocal proponents), Chinese FDI stock surged in 2015 and 2016, mirroring acquisitions by the, meanwhile troubled, Chinese energy firm CEFC, although accounting for an extremely low share of total FDI, as in other CEECs. The comparatively high level of Chinese FDI stock in Latvia is likely to be linked to the country’s golden visa schemes and to real estate investment by Chinese citizens.3

China’s infrastructure construction projects

Data on Chinese infrastructure construction projects vary significantly across sources. A 2017 IMF report sets the total project value currently financed by China for railways, energy and roads in the Western Balkans at €6.2 billion (FYR Macedonia: €0.6 billion; Montenegro: €0.9 billion, Bosnia and Herzegovina: €2.1 billion, and Serbia: €2.6 billion). According to the MERICS BRI database, since 2013 China has (co-)financed completed infrastructure projects worth US$715 million in the 16+1 region and Chinese-funded projects of over US$3 billion are under construction. Chinese road and rail construction projects have encountered challenges – all linked to Chinese lending practices – in several CEECs, such as Hungary/Serbia, FYR Macedonia and Montenegro. In some instances, these projects have produced a negative impact within an existing weak governance and rule-of-law
context. Attempts to circumvent EU rules requiring open tenders for infrastructure construction with regard to China's flagship Budapest-Belgrade railway project have triggered investigations at EU level and have entailed delays and cost overruns. Ultimately, Hungary agreed to an open tender but classified the project's feasibility study. The project now carries a price tag of US$3.6 billion and the Hungarian section, it is estimated, will take between 130 and 2,400 years to break even.

Chinese loans have been widely used for infrastructure construction projects in the Western Balkans. Although EU legislation is not yet legally binding for (potential) candidate countries, under the Energy and Transport Community Treaties they have committed to adopting the EU's energy and transport acquis and related standards (e.g. environment and competition) before their EU accession. In most cases, if not always, host countries award contracts directly to Chinese firms rather than through open tenders.

FYR Macedonia is a case in point. After a change of government, it transpired in the context of the wiretapping scandal that Chinese Sinohydro, recently blacklisted by the African Development Bank, had been selected in confidential procedures as the main contractor for the Chinese loans for the Kicevo-Ohrid and the Skopje-Štip motorways, and that contracts had been directly allocated to local subcontractors linked to political elites seeking political gains in the next elections. According to the IMF, the Chinese loan for the first section of the Bar-Boljare motorway in Montenegro has increased the country's debt-to-GDP ratio to nearly 80% in 2018, compared to 59% had the motorway not been started. It has thus raised concern as regards the risks for Montenegro's fiscal stability and its slipping into a debt trap. Western financial institutions had refused to fund the project, considering it non-viable. These practices risk undermining the EU's good governance reforms in the Western Balkans, including the strengthening of the rule of law and the fight against endemic corruption, as host countries have reportedly adjusted their laws 'ad hoc' to China's demands.

In a recent public tender for the construction of the Pelješac bridge in Croatia, which is co-financed by the EU at 85%, a Chinese state-owned enterprise was awarded the contract. European co-bidders have challenged the outcome of the bidding process without success, arguing that Chinese state aid, which is assumed to be involved, is incompatible with EU competition rules.

Chinese energy infrastructure construction projects in the CEECs have not been without controversy, since they often – reportedly based on local preferences and natural endowments – (may) materialise as new Chinese-financed and Chinese-built coal-fired plants (Kostolac 3 in Serbia, Tuzla 7, Banovici, Gacko II and Kamengrad in Bosnia and Herzegovina) that increase host countries' carbon emissions rather than reducing them to EU standards. In Romania, several energy projects have stalled due to political resistance and renewable energy projects have been short-lived. At the Sofia summit, China proposed to invest in Bulgaria's controversial Belene nuclear power plant.

**Chinese lending practices**

The standard features of Chinese (concessional) loans for infrastructure construction are incompatible with EU norms and regulations, notably with the EU public procurement rules on open and competitive bidding procedures. Chinese loans, whose terms are not disclosed, are based on intergovernmental agreements that do not envisage public tenders but are tied to a Chinese main contractor, usually a Chinese state-owned enterprise (SOE), and a high level of involvement of Chinese workers, material and equipment. Apart from being hardly conducive to boosting employment in host economies, these practices are also prone to sustaining weak governance. Moreover, Chinese loans usually require state guarantees. In the event of litigation, these fall under the remit of Chinese courts rather than of host country courts; this, given the specificities of the Chinese judicial system, is likely to reduce host countries' chances of a positive result.

Chinese loans have long maturity periods, their interest rates vary according to the Chinese input and they are available much faster from Chinese policy banks than loans from Western financial institutions. They come 'with no strings attached', i.e. without political conditionality intended to promote good governance, environmental, social and fiscal sustainability and the fight against corruption. More often than not, Chinese-financed infrastructure projects are carried out, although they have been considered economically or financially nonviable by Western banks and thus present a significant risk of host countries being drawn into fiscal instability. In addition, Chinese workers are usually subject to Chinese labour law, and Chinese imported materials and equipment are exempted from VAT or customs duties in host countries.
The EU response to the 16+1 format

The EU is present at the 16+1 summits as an observer, and in 2016 agreed an EU strategy for China. It outlines the principles that underpin the EU’s engagement with China (such as reciprocity, a level playing field, and transparent public tenders) and all EU Member States have endorsed it. In the framework of the EU-China Connectivity Platform, set up in 2015, a list of infrastructure projects both in the EU and in China has been identified for potential implementation. A June 2018 own-initiative report on EU-China relations by the European Parliament’s Foreign Affairs Committee (Rapporteur: Bas Belder, ECR, the Netherlands), due to be debated in plenary in September 2018, stresses among other things that Member States’ participation in the 16+1 format must enable the EU to speak with one voice in its relationship with China.

As for the Western Balkans, in the 2007-2017 period, the EU invested more than €8.9 billion in the region through the Instrument for pre-Accession Assistance. In response to China’s growing presence in the Western Balkans, in 2014 the EU launched the Berlin Process. The latter has created new regional dynamics under the EU’s Connectivity Agenda for the Western Balkans, which by July 2018 had provided grants for 31 infrastructure projects in the region. At the Berlin Process summit in Trieste in July 2017, a multiannual action plan for the development of a regional economic area, including trade, investment, mobility and the digital market, was adopted. In February 2018, the EU published a new enlargement strategy for enhanced engagement with the Western Balkans.

ENDNOTE

1 A. McCaleb and Á. Szunomár, Chinese foreign direct investment in central and eastern Europe: an institutional perspective, in J. Drahokoupil, Chinese Investment in Europe: corporate strategies and labour relations, 2017, pp. 121-140.
2 The European Council on Foreign Relations (ECRF) published a list of transactions covering the 2005-2017 period based on Heritage Foundation data as an attachment to its analysis: China at the gates: A new power audit of EU-China relations, 2017. However, it is worth mentioning that not all transactions listed have actually materialised.
3 For further information on Chinese FDI flows/stock in some other CEECs, please see European Think-tank Network on China (ETNC), Chinese Investment in Europe: A Country-Level Approach, December 2017.
4 China’s global energy investments in 2000-2016 were mainly in fossil fuels, i.e. US$54.6 billion in oil, US$43.5 billion in coal, US$18.8 billion in natural gas, compared with US$2.4 billion in solar, US$1.7 billion in wind, and US$24.9 billion in hydropower. K. S. Gallagher and Qi Qi, Policies Governing China’s Overseas Development Finance, Implications for Climate Change, 2018.

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