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Experiences with Chinese investment in the Western Balkans and the post-Soviet space: Lessons for Central Europe?

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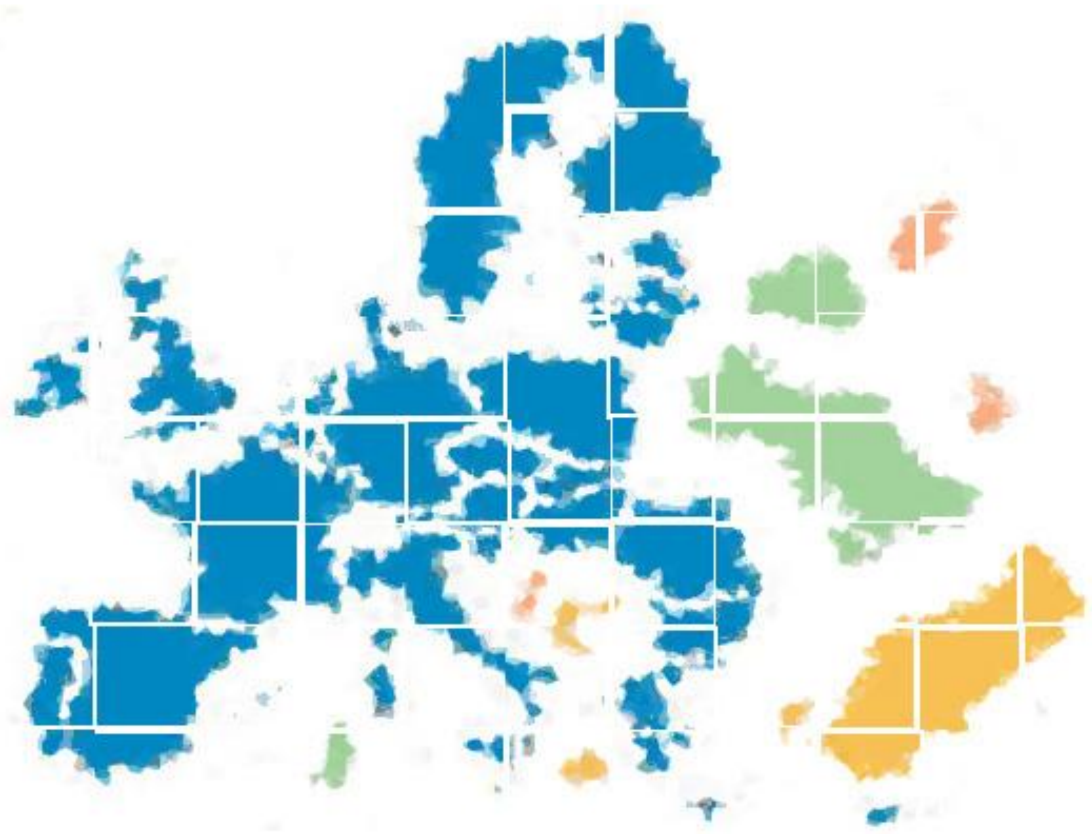

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Introduction

by Łukasz A. Janulewicz

Introduction

As China's global role is increasing, its influence is being increasingly scrutinized. The Belt and Road Initiative is probably the most visible manifestation of China's global aspirations. Much attention is being paid to its role in Africa and Asia. Publications highlight the 'Backlash to Belt and Road' in Central and Southern Asia, [1] the notorious 'debt trap diplomacy' also associated with China's investment in Asia and Africa[2] or the potential risks for governance in fragile states.[3] Nevertheless, other analysts highlight the opportunities and benefits of Chinese activity in these regions.[4] At the same time, Western Europe is also getting weary of China's growing role in Europe' economy amidst concerns about 'technology and know-how outflow'.[5] The same goes for China's takeover of key port infrastructure in the Mediterranean and the North Sea.[6]

The purpose of this publication, and the conference from which it emerged, is to try to take stock of the experiences of Central Europe's neighbours that were far more exposed to China's and by reviewing Central Europe's own interactions with China's investment efforts so far to think about which of these experiences from the post-Soviet region and from the Western Balkans should be taken into account by Central European countries in their dealings with China.

The Central European region plays a key role in these plans the gateway to Europe. At the same time, Central Europe's appetite for investment and infrastructure projects has not yet been saturated. China is offering an alternative source for such investment and political contacts are increasing across the region, particularly visible in the 16+1 Format. In the current political climate some regional leaders, like Hungary's Prime Minister, appear increasingly attracted to Chinese capital, while others are far more cautious. [7] Therefore, we hope this publication will make a contribution to the debates about

[1] E.g. Andrew Small, The Backlash to Belt and Road: A South Asian Battle Over Chinese Economic Power, Foreign Affairs, 16 February 2018, https://www.foreignaffairs.com/articles/china/2018-02-16/backlash-belt-and-road

[2] The Economist, The perils of China's "debt-trap diplomacy", 6 September 2018, https://www.economist.com/asia/2018/09/06/the-perils-of-chinas-debt-trap-diplomacy

[3] Jing Gu and Rhiannon McCluskey, Is China's Role in African Fragile States Exploitative or Developmental? IDS Policy Briefing 91, 1 March 2015, Brighton: Institute for Development Studies

[4] J. Peter Pham, Abdoul Salam Bello and Boubacar-Sid Barry, Chinese Aid and Investment Are Good for Africa, Foreign Policy, 31 August 2018, https://foreignpolicy.com/2018/08/31/chinese-aid-and-investment-are-good-for-africa/

[5] Euobserver Ticker, *Berlin wants tougher controls of company sales to China*, euobserver.com, 29 January 2018, https://euobserver.com/tickers/140735?fbclid=IwAR0Qu1CriGR-sy6mykd9xe_OvQSs2IDcB1PwioGchLR8zQo3R5MhsgcheAk

[6] Keith Johnson, Why Is China Buying Up Europe's Ports? Foreign Policy, 2 February 2018, https://foreignpolicy.com/2018/02/02/why-is-china-buying-up-europes-ports/

[7] Lili Bayer, China hits roadblocks in Central Europe, Politico.com, 26 November 2017, https://www.politico.eu/article/china-hits-roadblocks-in-central-europe/

China's role in Central Europe and the ever intensifying scrutiny that Chinese investment generates all across the European Union.

The first contribution, by Jacopo Maria Pepe, reviews China's investments in Central Asia. He highlights rapidly growing Chinese investment in the region and the compatibility between China's state-led development approach and the political realities of Central Asia. The chapter also points out that the economic challenges some Central European countries are currently facing might, in combination with growing Chinese investments, develop into an asymmetrical dependency, in parts not unlike that one can observe in Central Asia.

Anastas Vangeli, in the second contribution, take a closer look at the situation in the Western Balkans. He highlights the limitations of the traditional Western model of infrastructure investment and the alternative funding source that China provides for the countries in this region. He also points out that the bold Chinese approach towards risky infrastructure projects has been a necessary wake up call for the economic stagnation in the Western Balkans, albeit the lacking emphasis on prudence, accountability and efficiency has proven challenging for the governments of the region. Ultimately, he argues that while there are substantial challenges in many projects, these have been addressed creatively in many cases and long-term potential is being positively assessed in the region.

Turning our attention to Central Europe, the third contribution by Richard Q. Turcsányi, compares the Western Balkan experience with that of the Visegrad countries. It highlights the limited appeal of the Chinese offer for Central Europe, due to more attractive EU funding and EU public procurement regulations, in contrast to the real alternative that China offers to the Western Balkans. The Chinese approach, as he argues, also fails to address political sensibilities in Central Europe and has not yet undertaken steps to address these sufficiently.

Ágnes Szunomár, in contribution number four, further develops the Central European perspective on Chinese investment, with particular attention to Hungary. While China's investments are growing and could provide alternatives to the dependency on Western Europe, their overall role is still minimal. Thus, as in the case of the Orban government, political considerations rather than economic rationale are driving closer ties to China at the moment.

The final contribution, by Una Aleksandra Bērziņa-Čerenkova, takes a different perspective and investigates the operation of Chinese investments at the national level, focusing on the case of Latvia. She takes the unusual perspective of SME investments, in contrast to the widespread focus on large Chinese investments, often pursued by major state-owned corporations. Her findings suggest that such smaller and private Chinese investment can avoid many of the problematic practices associated with major Chinese projects.

China´s investments and investment policy in Central Asia: which lessons for Central Europe?

by Jacopo Maria Pepe

Introduction

This paper briefly discusses and evaluates China´s investments and investment policy in Central Asia from the point of view of Beijing's general geoeconomic and geopolitical interest for the region as well as possible lessons (if any) for Central Eastern Europe.

It will, first, present the evolution of China´s ties with Central Asia in the past 20 years both in terms of trade and investments and China´s goals in the region. Second, it discusses China´s investment policy instruments and their economic and political impact on Central Asia. And third, it attempts to draw lessons from the Central Asian experience for CEE by comparing China´s investment and trade politics in Central Asia with China´s rising influence in Central Eastern Europe in the framework of China´s Belt and Road Initiative and Made in China 2025.

The role of Chinese investment in Central Asia

China´s trade and investment in Central Asia started from a very low basis, took almost two decades to kick-start. Notwithstanding the small size of the regional markets and the small share of Central Asia in China´s total trade and investment, China´s interest in Central Asia is long-term and multipronged and the region lies at the core of China´s security, foreign and foreign economic policy.

China relations with Central Asia have dramatically evolved since the end of the cold war, with trade and investments expanding particularly since the early 2000s. China's relation with the region was almost non-existent during the Cold War, when the Sino-Soviet border was one of the most sealed in the world. Shortly after the break-up of the Soviet Union, however, China rapidly established diplomatic relations with the Central Asian states and settled centuries-old territorial disputes by signing treaties with many of them. This led to the reopening border crossing points and physical links and paved the way for expanding and deepening economic and trade ties before the BRI was launched.

However, it took more than 10 years to kick-start these relations and almost 20 to establish China as a major economic and financial player in the region: it was only in the early 2000, with the launch of the "Western Development Strategy", that economic ties, trade and investment ballooned. While the launch of the BRI has functioned as a catalyst for accelerating trade and investment instruments since 2013, these started to rise before it, with a sudden increase particularly since 2008-2010, as consequence of the global financial and economic crisis.

In terms of trade, China is particularly dominant as a trade partner in all five central Asian Countries. China has already become the first single trade partner for some of them (Turkmenistan, Uzbekistan, Kirgizstan) or challenges directly

Russia´s traditional position (Kazakhstan, Tajikistan). Considering the whole region, bilateral trade reached 30 Billion USD in 2017 from roughly 1 Billion USD annually in the 1990s. China has already surpassed Russia as top trader and is second only to the EU. The trade boom has been based on complementarities between China and the economies of Central Asia. China´s imports from Central Asia are mainly oil and gas (70%) from Kazakhstan, Turkmenistan and, to a less extent, Uzbekistan. For its part, China has increased the exports of electronics, household appliances and, particularly after the launch of the BRI, industrial machinery and transport equipment.

In terms of investments, the FDI stock has sky-rocked from less than 45 million in 2003 to 7.5 Billion in 2012, largely concentrated in the oil and gas sector, with Kazakhstan being the biggest recipient. After the launch of the BRI, however, investments have diversified to include agro-industry, petrochemical industry and logistics. Also, they are increasingly modelled on the concept of the International Capacity Cooperation and Financial Support developed first with Kazakhstan in 2014. Moreover, Chinese investments happen in form of Financial Aids more than FDI. Kazakhstan is the biggest recipient with different agreements signed since 2014 and 51 projects being realized under the BRI initiative and the International Capacity Cooperation scheme, worth 27 Billion USD.

From an analysis of the evolution of China´s investment policy, the main overriding interests behind China's investments in Central Asian countries are seemingly 4, all long-term, and not influenced by short-term setbacks or failures.: to diversify energy imports away from the Middle East by building needed infrastructure; to stabilize the Western regions, particularly Xinjiang, by strengthening cross-regional economic and industrial development, to promote and protect PRC economic interest in the region and beyond by building transport and logistic corridors in order to internationalize own production capacity, value and supply chains and to reach out to new markets along the southern border of Eurasia (from East to west Asia, Middle East and Central Eastern Europe); to increase and secure political influence by attaching political conditionality to the financial aid.

China's Investment Instruments

China´s Investments in Central Asia are a complex mix of direct investments, aid and loans, free of conditionality but linked to political loyalty. The central Asian case augments the risks factors inherent in China´s investment policy, even though central Asian elites are still betting on BRI and synchronize their domestic initiatives to China´s investments.

China investment policy in Central Asia does not differ from China´s general scheme: it is a complex mix of foreign direct investments, foreign aid, trade agreements and particularly financial loans. The main characteristics of China´s aid is the lack of conditionality on good governance, human rights and market-oriented reforms as required by the OECD. China is not a member of the OECD and is not obliged to comply with DAC (Development Assistance Committee) guidelines on foreign aid. While China understands bilateral investment cooperation as a win-win scheme which does not imply any form of political transformative conditionality in the recipient country, Beijing's investments policy implies political loyalty on critical political issues for Beijing like the One China Policy, relations with Taiwan, cooperation in regional security operation against separatism, alignment with Beijing at UN level.

In terms of loans, in Central Asia China has typically provided governments of the region with loans in exchange for the right to extract and transport mineral resources, attached to direct investments in extractive industry. This has been the case in Kazakhstan or Turkmenistan, with the construction of the CAC oil pipeline and the Turkmenistan-China gas-pipeline, matched by China´s increased FDI in the upstream and increasingly, in the downstream sector.

Since the launch of BRI, however, particularly in Kazakhstan, the International Capacity cooperation scheme represents a new integrated form of investment in line with the goal of „Made in China 2025" and of the BRI. It combines a mix of finance support/loans by policy banks and offshoring of production activities by Chinese companies in the industrial and equipment manufacturing sector which goes beyond the oil and gas sector. In Kazakhstan this involves particularly the chemical, mining, metallurgical, agricultural, machine-building and rail&logistics sectors as well as in the electronic and IT sector (Huawei and Alibaba), in Kirgizstan the agribusiness.

For Central Asian regimes, investments are much needed in these spheres and make strategic sense as these countries need to re-link to regional and global value and supply chains and diversify their economy. Given the nature of these regimes, they generally welcome Chinese investments. For instance, Kazakhstan has been eager to synchronize its domestic development plan Nurly Jol with the BRI. While China´s investments don´t threaten the stability of these regimes, diffused anti-Chinese resentment in the population and growing political dependence represent indeed an increasingly debated issue among the elites.

In fact, China´s investments policy presents three critical factors, which are augmented in the case of Central Asia

A) Debt trap: China's generous loans are contributing to a serious debt spiral in Central Asia—about 40 percent (or US$1.5 billion) of Kyrgyzstan's public debt, and 50 percent (or US$1.1 billion) of Tajikistan's, is owed to Chinese institutions (mainly, China Export-Import Bank, or Exim Bank). This number are however lower for Kazakhstan, which has more diversified trade relations.

B) Lack of technology transfer, soft infrastructure, effect on local employment: a large share of the funds injected by China into Central Asia never leaves the Chinese system: a loan granted by a Chinese bank to a Central Asian government is reinvested in the Chinese company that got the contract, which brings Chinese equipment and a Chinese workforce to Central Asia to carry out the project. This closed system favors hard infrastructure over soft one and only partially spur the improvement of the investment climate, increase good governance, and foster the emergence of new tertiary economic sectors requiring local high-level human skills, all elements desperately needed by Central Asian countries, which have a young but largely unskilled population in need of employment

C) New unilateral economic (and political) dependency: as the case of Turkmenistan demonstrates, unilateral „ultra-connectivity" with China does not end up in greater economic developments while on the long-term, it can doubtless increase political dependencies from China´s foreign policy agenda.

Lessons for Central and Eastern Europe

Which lessons, if any, can be drown for Central Eastern European countries? By several critical differences between the Central Asian and the Central Eastern European case, few lessons can be drawn: China´s successful "inroads" is slow and long-term; is function of local dysfunctionalities, lack of regional coordination/integration and absence of strong regional players.

On a more general, geopolitical level, China sees both Central Eastern Europe and Central Asia as crucial "interstitial spaces", i.e., those spaces located at critical geographic junctures of the Eurasian landmass which can connect to greater regional geo-economic spaces and can be used as an off-shore production platform for the own industry to access and establish itself in new markets. Moreover, Central Eastern Europe and Central Asia are considered not only bridges to other external spaces but also part of an interconnecting Central Eurasian economic and transport space stretching from western Xinyang to the Danube plain via Caspian, Black and Mediterranean Sea and which is targeted by the BRI initiative. Hence, investments activities of Chinese companies and banks should always be considered from this more holistic point of view.

However while China´s investment policy follows a general and relatively undifferentiated "modus operandi" which poses similar challenges in different regions and countries, and acts under a more or less coherent geostrategic scheme, its impact in Central Asia differs greatly from that in Central Europe:

First, Central Asian countries are largely raw material-based and poorly diversified economies, scarcely integrated in regional and global supply chain and depend heavily on China´s demand for oil and gas and on China´s quick and affordable loans. Their authoritarian regimes welcome the Chinese loans, which don´t threaten the regime´s stability. Their economic and political weakness make them however particularly vulnerable to China´s quest for political loyalty.

On the contrary, Central-Eastern European EU-Members are largely manufacturing and service economies, strong integrated in European, and specifically German´s value and supply chains and in the EU´s legal framework. Consequently, the influence of China´s investments and of its approach is still limited, challenged by the EU´s strong norms and standards requirements. For CEE, China is currently scarcely a relevant source of investments, as in the case of Central Asia, and, for now, no serious alternative to the EU in terms of trade. Otherwise, EU membership and integration in logistic, transport and production chains represent a guarantee against deepening Chinese involvement, as the negative case of Western Balkans shows.

Second, the lack of geographic proximity and of immediate security threats for China´s internal stability makes ties with CEE for Beijing a less urgent political issue than Central Asia. Beijing's degree of political influence based on asymmetric economic dependencies, is in CEE likely to be more function of the decision of some Central Eastern European countries to play the "Chinese card" than a declared, vital Chinese interest to transform them in "loyal political tributary."

Conclusion

This all being said, some useful, long-term lessons can be drawn for CEE from the Central Asian experience:

a) China´s economic influence grows over long-time and short-term failures might turn into long-terms victories.

b) It grows the more, the less a region is integrated in existing regional production and supply chains <u>or</u> the more the incumbent regional pivotal power is in retreat, fragmenting or not paying attention (Germany/EU in the case of CEE as compared to Russia in CA)

c) In the long run, challenges in the present CEE´s economic model and China´s evolving strategy toward high-value production could expose some CEE to greater dependence on China´s investments replicating the CA-China asymmetric scheme. More vulnerable to political and economic dependency are the countries of the Western Balkans, but some V4 countries are faced by increasing challenges related to the combined effect of strained political relations with the EU, rapid economic growth, over-dependency on German and European production chains and intra-EU trade, increasing scarcity of skilled working force, disruptive economic transformations and the need for better regional connectivity. In the long run, all these factors and the mix of China´s growing investments and political influence could turn into an element of greater, asymmetrical dependence from Beijing.

On Sino-Balkan Infrastructure Development Cooperation

by Anastas Vangeli

Introduction

In the neoliberal common sense, large infrastructure projects are increasingly deemed too costly and unprofitable. They are public goods intended for "free use;" to the neoliberal mind, there is often no feasible way how to make profit off of them, especially in poor countries. Such thinking has made Western creditors wary of supporting large infrastructure projects in developing and transitional economies whose development is hampered by striking infrastructure gaps, such as those of the countries in the Western Balkans. In cases where funding for infrastructure has been available, it has been reserved for those who follow the neoliberal doctrine. A recent report by the IMF has argued that the Western Balkans "faces significant public infrastructure gaps [which] constrain private sector development and integration into European supply chains and are an obstacle to faster income convergence" [8]. Yet, according to IMF experts, despite the urgency, infrastructure projects must not be pursued right away – as there are several of structural reforms to be done first, which can take years to be done.

For China, a country that has emerged as a champion in infrastructure construction at home, and as an increasingly active promoter of cooperation in connective infrastructure development around the world, the value of infrastructure lies precisely in the fact that infrastructure projects are public goods which enable wider economic activity. The Chinese approach is based on the logic that "if you want to get rich, you should build a road first" and "if you want to invest now, you need (and should be able) to borrow money," which is in line with the assumed national right to development. After all, this is how China did it – and according to China every country has the right to do it as well, while China is willing to assist, but also to co-benefit from this process. In theory, as Chinese policymakers and experts argue, the new economic activity that is stimulated with the construction of the new infrastructure (that stems from the flow of people, ideas and the diffusion of economic activity, and other unforeseen effects), is expected to boost public revenues, which is how infrastructure projects will eventually pay for themselves in the future. A recent report by AidData using a global dataset shows that "Chinese development projects in general, and Chinese transportation projects in particular, reduce economic inequality within and between subnational localities" and "produce positive economic spillovers that lead to a more equal distribution of economic activity."[9] Furthermore, to ensure that infrastructure does indeed lead to economic successes, to its partners

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8 Ruben Atoyan and Dóra Benedek, "Public Infrastructure in the Western Balkans: A Highway to Higher Income" (International Monetary Fund, 2018), https://www.imf.org/en/News/Articles/2018/02/01/na020818-public-infrastructure-in-the-western-balkans-a-highway-to-higher-income.
9 Axel Dreher et al., "Aid, China, and Growth: Evidence from a New Global Development Finance Dataset," SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, October 1, 2017), https://papers.ssrn.com/abstract=3051044.

worldwide, China offers broader developmental packages, a narrative, and a vision for economic development (for example, through the Belt and Road Initiative [BRI]) of how to put the new infrastructure to use. Even if lately China has recognized the need to shift towards a more commercial logic in the provision of loans for infrastructure projects, the core normative foundations remain different from the West (and so is the tolerance to risk). The difference in the constitutive principles of the two approaches, defined as ideal-types (not as clear-cut ones) is summarized in Table 1 below.[10]

	Western Approach (transactional)	Chinese Approach (relational)
Core argument	"Reform first, build later"	"Build a road first"
Cooperation motivation	Rules-driven	Vision-driven
Reference points	Abstract principles	Material outcomes
Context	Insular project	Broader developmental package
State role in the economy	Supporting	Leading
State imperative	Respect (international) norms	Right to national development
Fiscal logic	Transactional	Possibilistic
Cost-benefit approach	Focus on costs	Focus on benefits
Expected returns	Monetary (internal rate of return)	Added value (external rate of return)
Repayment of loans	Strict	Flexible
Core criteria	Fiscal fitness, feasibility	Good relations (*guanxi*)
Selection process	Competitive, technocratic	Discretionary, political
Political conditionality	Domestic reforms	Diplomatic support
Internal conditionality	Rules and regulations	Hire Chinese SOE as a partner
Implementation mechanism	Public bidding through tender only	Tender *or* special legislation
Narrative of the project	Technical - bureaucratic	National endeavor for growth

Table 1. Comparison of the Western and the Chinese approach to infrastructure development cooperation

China has thus been particularly encouraging and focused on the promotion of infrastructure projects in developing and transitional economies. In the Balkans, the Chinese option has emerged not as an alternative, but rather a form of a backup or safety net for instances where the Western input was not enough. The key connective infrastructure projects in which China participates in the region, are perceived as being of national importance by the respective governments. Some of these projects have been previously avoided by Western creditors: the

10 For general discussion on the two models of infrastructure development see the talk by Francis Fukuyama at UC San Diego, February 2018, https://gps.ucsd.edu/news-events/news/chinas-infrastructure-investment-as-a-development-strategy.html

Balkan countries are small, poor, outside of the EU, and still struggling to make all the necessary reforms. Moreover, some of the new highways happen to pass through challenging mountainous terrain, that further raises their cost. In pursuing these projects, Balkan governments embraced the China-inspired model of development cooperation in building connective infrastructure: national governments played central role; some of these projects were implemented via special laws; they were financed via "tied loans" scheme – Chinese development banks provided credit under relatively favorable terms, and in return key partners in the implementation are Chinese SOEs (although in some cases, the majority of the work was done by local subcontractors). A list of some of the key connective infrastructure development projects in the Balkans are listed in Table 2.

Country	**Project**	**Value**	**Financial terms**	**Status**
AL	Blue Corridor Albanian Section	Unknown	Unknown	Feasibility study
BiH	Banja Luka – Split motorway (section in Republika Srpska)	€600mn	Credit, 30 year concession	Planning
MNE	Section of the European motorway XI	€809mn	Credit	Advanced stages
RS	Danube bridge	€170mn	Credit	Completed
RS	Belgrade-Budapest high-speed railway link (section in Serbia)	€800mn	Credit	Works to begin in 2018
RS	Sections of the European motorway XI (to Montenegro)	€900mn*	Credit	In construction
MK	Kichevo-Ohrid and Miladinovci-Shtip motorways	€580mn*	Credit	In construction

Sources: Pavlićević[11] and own research; * indicates cost overruns

Today, these infrastructure projects are the trademark of Sino-Balkan cooperation. However, what is central to them is not only the role of China, but first and foremost the role of local agency: these projects were not imposed on the countries in the region by China; but it was their governments who consciously pursued them, taking upon significant responsibility. These projects, in the local and the global discourse, are often mistakenly called "Chinese investments" - in reality, they are governmental investments done in partnership with China.

11 Dragan Pavlićević, "A Power Shift Underway in Europe? China's Relationship with Central and Eastern Europe under the Belt and Road Initiative," in *Mapping China's "One Belt One Road" Initiative*, ed. Xing Li (Palgrave, forthcoming).

The Balkan governments' decision to work with China was primarily a utilization of the newly available Chinese option. By 2011, Chinese SOEs started providing both solicited and unsolicited bids for infrastructure projects in the Balkans, in a context of little to no competition or interest by other donors. Moreover, China's "charm offensive" in the region via the 16+1 framework and the BRI helped in popularizing the Chinese approach and "wisdom" in infrastructure construction. Most importantly, however, Balkan governments saw the possibility of cooperation with China as a "shortcut" to improving their connectivity. This process was underpinned by fascination with China, embracing a new geoeconomic imaginary, and a belief that yet again an outside actor will bring prosperity to the region. In theory, China was supposed to provide a quick fix for one of the most burning needs of the Balkan governments (infrastructure development), while not interfering with the domestic policy agenda. What they have overlooked, however, that construction of large infrastructure projects is much peskier than it seems.

Overall, the infrastructure projects done in cooperation with China in the region so far have a mixed record. While some are developing as planned, in some of the cases (in particular the highways constructed by Sinohydro in Macedonia, funded by the Chinese ExIm bank; and to some extent the highway constructed by CRBC and funded by the ExIm bank in Montenegro), implementation turned out much more problematic than initially foreseen, as it was plagued by problems such as corruption, lack of due diligence, delays and cost overruns – the looming threats to all infrastructure projects, that have made infrastructure an unattractive business to begin with. It is important to note that a great share of the responsibility for the complications in the project implementation was a result of the lack of capacity on the side of the Balkan governments themselves. Especially relevant here are the instances of corruption in the Macedonian case, where the former government has been charged for corruption in a number of other cases, including infrastructure projects implemented in partnership with EU companies.

Nevertheless, all of the projects – even the problematic ones – are under construction and in a good shape, and according to official sources would likely prove to be successful upon their completion (even it the cases with delays). Yet, the complications in some of them have produced bad publicity for the whole of the cooperation with China. In particular, their contextualization in the new narratives of the new *China Threat* in the West – for example, turning the Balkan countries into a Trojan Horses via debt traps [12] – have made the Balkan governments particularly cautious towards taking up new connective infrastructure development projects with China, but it has also made Chinese

12 Ryan Heath and Andrew Gray, "Beware Chinese Trojan Horses in the Balkans, EU Warns," *POLITICO Europe*, July 27, 2018, https://www.politico.eu/article/johannes-hahn-beware-chinese-trojan-horses-in-the-balkans-eu-warns-enlargement-politico-podcast/

actors wary of scaling up their involvement in the region. Currently, there are no new projects being undertaken.[13]

At the same time, the Western criticism towards Sino-Balkan cooperation in infrastructure development was not only rhetorical. Having for years neglected economic development in the Balkans, Western actors themselves made counter-offers to China: for instance, even the Berlin Process initiated by Western European countries in cooperation with the EU as a supplement to the EU enlargement agenda, which has connectivity at its core, is framed as one of the responses to China. [14] Beyond the Balkans, the US is about to bolster its Overseas Private Investment Corporation (OPIC) with additional funding, with the goal to also counter China's offer – the work of OPIC is likely to extend to the Balkans as well. What these moves will deliver and whether their outcomes will be “more of the same” - a continuation of the existing Western approach, with all its benefits, but also with all its limitations – or a novel approach, in part, paradoxically, also inspired by China, is yet to be seen. At the same time, it is a bittersweet reality for the Balkan countries that it was China's interest in the region that sparked a greater activity from its traditional partners.

In conclusion, there are two inter-related points to be made based on this assessment of Sino-Balkan cooperation in connective infrastructure development. First, after almost three decades of the “monopoly” of the Western model of infrastructure development cooperation in the region, which has provided limited results, the Chinese model emerged as an additional option for filling the infrastructure gap. It brought enthusiasm, but also challenges and (international) politicization of the question of infrastructure development cooperation. Importantly, local agency has played a key role in the process, noting a mixed record. Nevertheless, the important thing is that Balkan governments – but also all stakeholders in the region including the EU – have gradually accepted the argument that we need to talk more about economy and infrastructure; and China played an important role in achieving this.

Second, the belief that achieving economic success requires bold and sometimes risky undertakings by national governments that characterizes the Chinese approach (and what the Western approach sometimes lacks), proved to be a prerequisite for initiating an economic movement in the rather stagnant economic context of the Western Balkans. At the same time, due diligence, financial prudence and efficient management of infrastructure projects – that are prioritized in the Western approach, and are considered weak points of the Chinese approach – were lacking, which complicated the implementation of the infrastructure projects in partnership with China in the region. This means that while their boldness and pro-activity is a welcome change, the Balkan

13 It can be argued that this may be also a result of the general shift of the Sino-Balkan cooperation from infrastructure towards production capacity cooperation and (re)industrialization; at the same time, one argument is that Chinese companies need to finish the ongoing projects first, so they can then move their machinery onto new ones – as according to insiders in the Sino-Balkan cooperation, the costs of machinery and its transportation have been a major challenge so far.
14 Gisela Grieger, “China, the 16+1 Format and the EU,” Briefing (European Parliament, September 2018).

governments also need to work on improving their capacity and accountability mechanisms, or in other words, capabilities are yet to meet the demand.

Yet, for now, the governments in the region seemed to have found balance even in the most problematic cases; this is to say that the Hirschmanian principle of the *Hiding Hand* eventually worked out in their favor. Decades ago Albert Hirschman[15] argued that large infrastructure projects are usually accompanied by the phenomenon of "providential ignorance" – while often costs and problems exceed the expectations of planners, they are usually offset by the capacity for creative improvisation in solving them. A contemporary case in point is the Kichevo-Ohrid highway, whose revisions turned to be so complicated that in announcing the Appendix which seeks to fix a number of technical and financial shortcomings of the initial project, Macedonian officials argued that if they had the chance to start over with the negotiations, they would have perhaps chosen not to pursue the project to begin with in order to avoid all the headaches. Nevertheless, at the same time, the same officials speak fondly of the long-term impact of the new highway, which is expected to contribute to the economic renewal of the country, and are proud of the state-of-the art tunnels and viaducts that are being completed, even if behind schedule. In a turn of events that Hirschman may have appreciated, one can make the case that even if their predecessors were ignorantly bold in undertaking a risky and costly project, eventually the incumbent Macedonian government managed to solve all the issues (and even indict the former corrupt officials) and proceed with the construction of a project of of utmost importance for its future economic development.

15 Albert O Hirschman, Cass R Sunstein, and Michele Alacevich, *Development Projects Observed* (Brookings Institution Press, 2015).

The peculiar case of China's (missing) Investments in Central Europe

by Richard Q. Turcsányi

Introduction: The experience with the 16+1 platform

China made a grand entrance into Central and Eastern Europe (CEE) in 2012 when it co-organized the Warsaw summit with 16 Prime Ministers from the region (eleven EU members and five Western Balkan EU candidate countries). Part of China's initial success in attracting attention have been the economic promises, most importantly that it would invest in the region. At the time, the CEE region was indeed 'cash-stripped', after its Western European investors withdrew part of their investments and even their demand for CEE products decreased as a result of the global crisis. The emerging superpower China seemed at first sight like an obvious answer to the problems of lacking demand and capital. [16]

Six years later, we have already gathered some evidence to assess the China-CEE experience and it is hard to avoid the verdict of economic disappointment, particularly when talking about Chinese investments. First, it is true that the amount of Chinese FDI did increase but it started to grow from extremely low levels and hence Chinese capital remains as marginal to CEE economic development today as six years ago. Second, the little Chinese FDI that did arrive have not gone into desired sectors, such as green field investments that would create new good quality jobs.

The Czech Republic might be regarded as an exception in Central Europe. It attracted about one billion EUR of Chinese FDI in recent years. However, for several reasons the Czech case is not so different from the other CEE EU members. First, the one billion of Chinese FDI is still far below of what has been announced.[17] Second, perhaps more importantly, Chinese FDI is based on acquisitions in the real estate and financial sectors. Thirdly, and most importantly, recent developments call into question the sustainability of existing Chinese investments. The company responsible for virtually all deals – CEFC – got into financial trouble and its Czech assets in the country were taken over by the state-owned investment vehicle CITIC. [18]There is a real possibility that CITIC might sell at least some of these investments. Moreover, the fact that it is state-owned means that it is difficult to sustain the argument about economic motivations behind Chinese investment.

The dynamics of Chinese investment in the region plays out differently for the five non-EU countries in the Western Balkans – Serbia, Bosnia and Herzegovina,

[16]Marta Golonka, *Partners or rivals? Chinese investments in Central and Eastern Europe* (Warsaw: Central & Eastern European Development Institute, 2012)

[17] https://www.tyden.cz/rubriky/byznys/cesko/ceska-a-cinska-strana-podepsaly-na-30-obchodnich-dohod_377869.html; https://www.scribd.com/doc/306382671/Seznam-dohod-podepsan%C3%BDch-b%C4%9Bhem-nav%C5%A1t%C4%9Bvy-%C4%8Dinskeho-prezidenta-v-%C4%8Cesku

[18] https://www.caixinglobal.com/2018-08-30/quick-take-prague-approves-citics-takeover-of-embattled-conglomerates-czech-assets-101320188.html

Macedonia, Montenegro, and Albania. These countries in fact managed to attract Chinese investment deals ranging from a few hundred million up to a few billion EUR, when measured by the American Enterprise Institute 'China Global Investment Tracker' project.[19]

It should not be seen as an 'arrogant Brussels-centric' assumption to find it surprising that the Balkan countries surpass Eastern EU members in terms of attracting investment flows. Research by the China Academy of Social Sciences, a government affiliated think tank, ranked the CEE countries according to their investment attractiveness for China. The results put the V4 countries on the very top while the five Balkan countries find themselves at the very bottom.[20]

Chinese investments in the V4: an offer that should be scrutinized

The obvious question then is why China invested in the Western Balkan countries and not elsewhere in the CEE region. The answer would also shed light on what lessons Central Europe can draw from this development in the Western Balkans.

On the rhetoric level, China approaches the CEE region emphasizing similar characteristics as, for instance, other East Asian or Western European investors underline: access to the European common market, geographical proximity to Western Europe, political and social stability, and a favourable ratio between the price and quality of inputs (including labour).[21] These factors made the EU members of the CEE region relatively successful economies in the 2000s thanks to the influx of foreign direct investments leading to the establishment of a production and service sector serving the Western European consumer markets.

Yet China is now overall at a much lower development level than Japan, South Korea or Taiwan who have already undergone the process of deindustrialization and outsourced their production. China probably hopes to move the production from its richest areas to lesser developed provinces rather than abroad. Hence, the main comparative advantage of the CEE is not something which China is seeking.

Looking at it from the opposite perspective, Chinese investments have been growing at a spectacular rate globally. Since 2002, the first wave targeted the developing countries with the goal of securing natural resources and building infrastructure. Particularly since the 2008 crisis, China has accelerated its investments into the developed world where it is interested in acquiring companies holding leading technologies or brand names. The problem with the EU members within the CEE region is that, from China's perspective, they are in the 'grey zone': they are too developed to be receptive to the kind of approach China employs in developing countries, but they are not developed enough to have the kind of companies China would like to acquire in the developed world.

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[19] See http://www.aei.org/china-global-investment-tracker/

[20] See Liu Zuokui, Liu, The Analysis of China's Investment in V4 in: Current Trends and Perspectives in Development of China-V4 Trade and Investment, University of Economics in Bratislava, Faculty of International Relations, 2014 (https://fmv.euba.sk/www_write/files/dokumenty/veda-vyskum/projekty/sucasne-trendy/China_V4.pdf)

[21] http://theasiadialogue.com/2018/08/29/positioning-central-and-eastern-europe-for-chinese-investors-qualitative-characteristics-of-chinese-investments-in-cee/

China's approach to the CEE region is mainly following patterns of its approach to other developing regions. China has established the 16+1 platform as the main tool to manage relations with the region – similarly as in Africa or Latin America.[22] One of the main tools of China to enter the region has been the offer of state credit linked to China-designed and constructed infrastructure projects. This is the Chinese mode of functioning in the developing world, but it has proven to be ill-suited for EU members, even if they are not as developed as the Western European ones.

EU members are expected to follow market rules for government procurement. In other words, government-funded infrastructure projects must run a public tender and pick a company to realize the work based on transparent factors. Moreover, as relatively stable and prosperous countries, they can borrow from the financial markets with relatively low interest rates.

To compare, the Chinese approach consists of a financial loan, which is often not even competitive when compared to the interest rates of government bonds. These Chinese loans come with the condition that it must be used for the specific project and with a certain share of contracting of Chinese companies. This combination of factors means that EU members have little interest to enter into this kind of endeavours. The long discussed railway upgrade between Budapest and Belgrade is a good example – although politically Hungary, as an EU member, seems to give full support to the project, even this is not enough so far to overcome EU rules. Moreover, the fact that the whole project might not be economical for Hungary causes significant delays. Eventually, the project may still be put in place, although it is highly questionable in whose interest that would be.

China in the Balkans: the South-South cooperation

On the other hand, the different situation of the Western Balkans means that China's offer is interesting for them, at least initially. Not having such good access to EU funds and the bond market, Chinese financial loans become a considerable alternative. This is the case especially when the Western banks refuse to fund project whose profitability is in doubt, and hence the ability of the recipient country to repay the loan. This is the case of the Montenegro North-South highway, which is now being constructed thanks to a Chinese loan and with Chinese companies and significant use of Chinese materials and labour.

Besides economics, there are also symbolic factors which increase the appeal of China in Western Balkan countries and reduce it among most other EU countries.[23] Occasionally, China labelled the 16+1 as being South-South cooperation and it used the rhetoric of developing countries improving their economic and political standing.[24] This might resonate better in former Yugoslav countries, which recall the memory of leadership of the non-aligned movement.

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[22] Jakub Jakóbowski (2018) Chinese-led Regional Multilateralism in Central and Eastern Europe, Africa and Latin America: 16 + 1, FOCAC, and CCF, Journal of Contemporary China, 27:113, 659-673

[23] This argument is inspired by the research of Runya Qiaoan (unpublished), presented at the University of Turku in October 2018.

[24] https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1319541.shtml

In Central Europe, however, the impression of already being part of the developed world is a source of national pride.

More importantly, the specificity of China's approach in the CEE region compared to other developing regions is that China talks of 'traditional friendship' and 'common history'. It explicitly recalls the communist past of these countries. The problem is that most of the Eastern EU members consider this part of their history as anything but a tradition to build current relations on. Rather, many of them treat the communist decades as an 'occupation'.

On the other hand, many Balkan countries have a different view. For them, communist times were an era of relative prosperity, stability, and some international respect, particularly invoking the Tito period in Yugoslavia. While the V4 and Baltic countries have more or less successful experiences with transformation during the 1990s and 2000s, the Balkan countries have been struggling not only with economic development but also with ethnic conflicts and the civil war, which lead to unimaginable atrocities. Hence, when China revokes the memories of communist times and the solidarity of the developing countries, it rings a bell in the Balkans but not so much elsewhere.

Conclusion

To conclude, there are a few takeaways from this situation. First, the Chinese approach towards the CEE region is rather contradictory. While, on the one hand, China does see it as a sub-forum of the EU-China partnership and it seems to identify the potential of the Eastern EU members in economic terms (and perhaps also political ones), on the other hand, its approach is designed in ways which are at times not appropriate, interesting, or even appealing to these countries.

It is a big question why China has still not adjusted its approach and continuously repeats this substandard offer. With progressing time, it is becoming less and less plausible to assert that China is not aware of the reasons why its approach falls on deaf ears outside the Balkans. That opens up more problematic explanations of China trying to change the reality in the region and push through with its offer, even though it might not fit the situation and standards in given countries and in the EU in general. While we can only hypothesize, Central Europe would do well to approach China with caution and keep its own interests firmly in mind.

Chinese investment in European peripheries: Who pays the piper calls the tune?[25]

by Ágnes Szunomár

Introduction

Without doubt, Europe has emerged as one of the top destinations for Chinese investment. According to Rhodium Group's statistics, annual foreign direct investment (FDI) flows in the 28 EU economies has grown from EUR 700 million in 2008 to EUR 30 billion in 2017.[26] That represents a quarter of total Chinese FDI outflows last year. However, the Chinese approach towards Europe is far from being unified since China follows different motives and uses different approaches when dealing with different countries or regions of Europe: the access to successful brands, high-technology and know-how motivates China when entering Western European markets, investments in the green energy industry and sustainability brings Chinese companies to Nordic countries, while greenfield investments (manufacturing) and recently also infrastructural projects pulls them to Central and Eastern Europe (CEE), including also the non-EU member Western Balkan countries.

It is difficult to determine whether it was a deliberate Chinese strategy or the lack of European cohesion that has encouraged China to deal bilaterally with individual member states (or groups of member states) but it certainly helped to achieve better results for China than engagement on the EU level. This is not a new phenomenon but characterizes China-EU relations from the early beginnings. This at least partly explains, why China decided to create platforms such as the 16+1 initiative or the China-Nordic framework: to enhance cooperation in different - economic as well as political - fields and to avoid, or at least delay and hinder, criticism at the EU level. European responses to these approaches also vary considerably in different regions of the continent: some countries have reservations about a growing Chinese presence while others welcome the resulting economic opportunities. Central and Eastern Europe - although opinions may differ from country to country - belongs to the latter group.

Chinese companies on CEE markets

Chinese companies have increasingly been targeting CEE countries in the past one and a half decades, while diplomatic relations are also on the rise. This development is quite a new phenomenon but not an unexpected one. On one hand, the transformation of the global economy and the restructuring of China's economy are responsible for growing Chinese interest in the developed world, including the European Union. On the other hand, CEE countries have also

[25] This paper was supported by the National Research, Development and Innovation Office (K-120053) as well as the János Bolyai Research Scholarship of the Hungarian Academy of Sciences.

[26] Hanemann, T. and Huotari, M., 2018. EU-China FDI: Working towards reciprocity in investment relations. Rhodium Group and Mercator Institute for China Studies, https://rhg.com/research/eu-china-fdi-working-towards-more-reciprocity-in-investment-relations/

become more open to Chinese business opportunities, especially after the global economic and financial crisis with the intention of decreasing their economic dependency on Western (European) markets. Here, China can benefit a lot from the EU's division between its core and periphery. For China, the region represents dynamic, largely developed, less saturated markets, new frontiers for export expansion, new entry points to Europe and cheap but qualified labour. This adds up to lower political expectations, fewer economic complaints, fewer protectionist barriers and fewer national security concerns in the CEE region compared to the Western European neighbours. The CEE countries' disappointment coming from the slower-than-expected catching-up processes to Western Europe also resulted in these countries turning towards the East.

Recently, Western diplomats, scholars as well as media have raised attention to the growing Chinese influence in the CEE region and the potential implications for the EU or even globally. This mostly concerns China using economic relations (mainly investments) and other financial tools with certain European countries to gain political influence in Europe. Undoubtedly, there are certain signs for this: Hungary and Greece prevented the EU from backing a court ruling against China's expansive territorial claims in the South China Sea, while Hungary's ambassador to the EU was the only one not signing a report criticising the Chinese Belt and Road Initiative for benefitting Chinese companies and Chinese interests.[27]

But are Chinese investments really responsible for China's growing influence in the CEE region as Western critics claim? The answer leaves room for doubts, at least.

When compared to China's economic presence globally or in the developed world, China's economic impact on the CEE countries is relatively small: They are highly dependent on both trade and investment relations with developed countries, mainly-EU member states, while China represents a minor (although increasing) share. From a Chinese point of view, as far as trade or investment statistics are concerned, the CEE region is also far from being among the most important partner of China. Since the main motivation of Chinese investment in the developed world is to access important technologies, successful brands and new distribution channels, Germany, the UK and France accounted for more than half of the total Chinese investment value last year within the EU, while the combined CEE region received less than five percent.[28]

Hungary, for example, is among the most popular destinations for Chinese FDI within the CEE region: while Chinese (MOFCOM) statistics show a rather modest stock of Chinese investment in Hungary (314 million USD), the Hungarian National Bank (HNB) - where statistics are broken down according to ultimate investors - displays 1782 million USD. Nevertheless, the dominance of EU partners has to be highlighted here, too: based on OECD and HNB statistics, more than 75 per cent of foreign investments are coming from EU countries,

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27 Heide, D; Hoppe, T; Scheuer, S; Stratman K, 2018. EU ambassadors band together against Silk Road. Handelsblatt Today, 04/17/2018, https://www.handelsblatt.com/today/politics/china-first-eu-ambassadors-band-together-against-silk-road/23581860.html?ticket=ST-5110475-xbAfutgQKGFoxtGktQhM-ap1

28 Hanemann, T. and Huotari, M., 2018. EU-China FDI, op. cit.

more than 25 per cent from Germany, while only 2.4 per cent from China. This 2.4 per cent share is, despite being the highest in Central and Eastern Europe by comparison, far from being decisive. It is also true, however, that although Chinese multinational companies represent a relatively small share, they have saved and/or created jobs (especially Wanhua and Huawei) and contributed to the economic growth of Hungary with their investments and exports. Furthermore, many of them (e.g. Lenovo, ZTE, Huawei, Bank of China) have turned their Hungarian businesses into European regional hubs for their activities.[29]

CEE within Belt and Road

Besides creating potential hubs/bridges/bridgeheads/gates for Chinese products - as many CEE leaders portrayed their own countries when talking about the potentials of strengthening ties with China - in the European Union, Chinese companies expressed their interest in several infrastructure-related investments in recent years, planned under a new framework, China's Belt and Road initiative. China's motivations are easy to understand, as the New Silk Road project expands China's political and economic sphere of interest: once the alternative transport routes are completed China will be in a more favourable strategic position, will have more and more alternative transport routes, can reach its target markets more easily and quickly and will be able to reduce some of the industrial overcapacities accumulated in recent years. In addition, these projects may provide a reference for further Chinese investment in the broader region, especially in the more developed part of Europe. [30]

Hungary was the first European country to sign a memorandum of understanding with China on promoting the Silk Road Economic Belt and Maritime Silk Road, during Chinese Foreign Minister Wang Yi's visit to Budapest in June, 2015. The Hungarian government was very keen on the Budapest-Belgrade railway project and when it signed the construction agreement in 2014, Prime Minister Orbán called it the most important moment in cooperation between the European Union and China.[31] Infrastructure development is indeed a hot topic in all CEE countries; however, there are other resources – for example EU funds – to finance them. Therefore, a more interesting - and for the time being unanswered - question is: what motivates the Hungarian side in building infrastructure with Chinese companies, using Chinese credit to finance it? Here, the political factor seems to be more important than any economic rationale.

The 16+1 Initiative

a unified Europe for several reasons, ranging from economic issues (such as export and import relations, market size, investment opportunities, high

[29] See Szunomár, Á; Mccaleb, A; Chen, X, 2018. Economic Relations between China and Central and Eastern Europe: Trade and Investment Issues. In: Weiqing Song (ed.) China's relations with Central and Eastern Europe: from "old comrades" to new partners. London: Routledge, pp. 48-65.

[30] See Szunomár, Á, 2015. Blowing from the East. International Issues & Slovak Foreign Policy Affairs, Vol. XXIV, No. 3/2015, pp. 60-78

[31] Keszthelyi, C, 2014. Belgrade-Budapest rail construction agreement signed. Budapest Business Journal17/12/2014, https://bbj.hu/budapest/belgrade-budapest-rail-construction-agreement-signed_89894

technology, etc.) and cooperation in climate change to international recognition or counterbalancing the US. Although we can never be sure about China's real intentions, it is possible that they are simply still learning how to deal with Europe. For example, when China decided to strengthen its relationship with the CEE region - by creating the 16+1 initiative - the original idea was that this process will bring China even closer to Europe. Subsequently, Beijing was rather surprised by Western fears that China tries to divide Europe and frustrate some aspects of the EU's common China policy through this initiative. This may explain that recently the Chinese Government offered Germany to be included in the 16+1 talks as an observer. Similarly, China started to think about having 16+1 summits every two years instead of annually. Further evidence is China's first infrastructure-building attempt in CEE: they tried to bring in the same package as in the developing world - Southeast Asia or Africa - not considering the different and sometimes very strict rules and regulations or standards of the EU. As a result, while Chinese foreign direct investment targets the EU member CEE countries, infrastructure projects are more prevalent in the non-EU CEE countries, where strict EU regulations do not apply.

Conclusions

From the CEE point of view, China can, of course, be able provide economic opportunities that would help to decrease the overly significant economic dependency on Western Europe. But - at least for now - this is not the case: as mentioned above, although Chinese trade volumes and investment stocks are on the rise in some of the CEE countries, this is far from being decisive or comparable to economic relations with EU countries. Referring to the title of this short overview, the 'piper' is still payed by the (Western) Europeans. Accordingly, in economic terms, CEE's genuine interest would be to not to risk its relationship with the EU. The fact that some CEE countries are 'calling new tunes', i.e. they act or vote in favour of China and fuelling conflicts with the EU implies that their further engagement with China might come from political considerations.

Starting Small - an Emerging Profile of Chinese SME Investors in Latvia to Challenge the Preconceptions on Chinese FDI

by Una Aleksandra Bērziņa-Čerenkova

The lack of progress in Sino-Latvian economic cooperation

During the recent Parliamentary election in Latvia, a total of 16 political parties from across the spectrum competed for the voters' trust. Regardless of ideology, however, most of the parties had one thing in common — cooperation with China did not appear in any of their foreign affairs platforms.[32] During the debates, even though economy related aspects were abundant and the positive role of FDIs for the Latvian economy was underscored, China as an originator of such FDIs was not mentioned by the candidates. Such a development can seem surprising given the "economic cooperation" discourse surrounding the "16+1" format and analyses of a rising Chinese presence in the region.[33]

Yet, the lack of China in the Latvian vision for economic growth can be easily explained. When the "16+1" was founded, the economy seemed to be at its centre, with business forums at the side-lines of every major "16+1" summit — "investment" stands as the primary aim of the initiative, only then followed by transport, finance, science, education, and culture.[34] However, similarly to how it has been described in the case of other EU member states that also take part in the "16+1", and admitted by China as well, the declarations and intentions have not resulted in major economic gains. For the last six years, since the establishment of China's transcontinental initiatives, be it Belt and Road or "16+1", Latvia has not yet witnessed an upsurge of Chinese investment — contrary to what was expected initially. At first, the incompatibility of China's offer, namely, the push for infrastructure loans that Latvia did not need, was mentioned as the primary reason behind the disappointing results. Later into the format, China adjusted the offer, centring on the promise of transport and logistics sector related investment. This time, more opportunities arose for Latvia's big transit market players, as they signed cooperation deals with counterparts in several regions of China. Still, the shift did not affect the lack of the FDI dynamic.

Smaller size as a solution — a case study

When analysing the narrow flow of Chinese investment to Latvia, incompatibility in size is often named as one of the key issues. To illustrate the

[32] Except for "Saskaņa": 13. SAEIMAS VĒLĒŠANAS. Centrālā Vēlēšanu komisija. 05.10.2018. https://sv2018.cvk.lv/pub/CandidateLists/CandidateList? id=ZTTi%2BonHCl%2BU6o9Y9odlVw%3D%3D
[33] See, e.g. David Scott. China and the Baltic States: strategic challenges and security dilemmas for Lithuania, Latvia and Estonia. Journal of Baltic Security. 21.06.2018. https://content.sciendo.com/abstract/journals/jobs/4/1/article-p25.xml
[34] "16+1" Summit has concluded. Cooperation between China and Central and Eastern European Countries.10.11.2016. http://www.china-ceec.org/eng/ldrhw_1/2016lj/hdxw4/t1414327.htm

point, an official of the Employers' Confederation of Latvia has said that "[…] even though referred to as small and medium, Chinese SMEs are still bigger in capital and workforce than some of our large enterprises. Therefore, no wonder that the companies that are referred to as big Chinese enterprises are sometimes bigger than all of our businesses combined."

Against such a pessimistic background, a new trend is emerging — since 2017, a wave of small Chinese businesses is starting to operate in Latvia or considering it. And these companies are hoping that investing in Latvia will help them go up the value chain.

One of the sectors receiving most interest from Chinese SMEs is wood processing. Forests constitute almost 50% of Latvia's territory, putting it in the 4th place in Europe by forest coverage ratio. The export of timber products accounts for a stable 20% of Latvian total yearly exports. Latvia's forests produce around 11 million cubic meters of timber per year, coming from state-owned and privately owned territories in roughly equal shares. [35] Clearly, such an amount of production is not enough to satisfy the needs for resources of large enterprises — even local Latvian companies at times face the exhaustion of the yearly quota and turn to importing wood from third countries for processing — still, a small scale business of China-bound niche products stands a chance.

Three Chinese SME investors interested in Latvia's timber processing sector have been interviewed for this article. Investor A has already successfully launched the operation in late 2018, producing small wooden objects such as ice-cream sticks. Investor B had originally planned to build a wood decor carving plant but has decided against Latvia. Investor C, an owner of several furniture plants across China, who would like to produce high-end designer kitchen fronts for further assembly in China, is yet to make his decision. Regardless of the different outcomes, interviews have revealed a few common traits among these three projects. These traits demonstrate an emergence of a new kind of flexible SME investor profile that could be a beneficial target for investment attraction.

1. Operation base — not in the capital. All three investors state that they started with the opportunities available in the capital, but quickly realised that the renting prices and other expenses would be too high. Therefore, they have turned to consider regions outside Riga, but with good infrastructure and logistic capacity. Therefore, the regions could possibly benefit from such projects.

2. Workforce — mostly local, with 2-3 invited Chinese equipment operators during the teaching phase. The Chinese companies (esp. Investor A) have been working closely with the Latvian State Employment Agency to search for the local workforce, offering an income slightly higher than the market average. The required skill set would be mostly technical. Chinese language knowledge would only be crucial for 1 local worker in a management position. Lack of workforce is named as the biggest obstacle.

[35] 2018 Meža nozare skaitļos un faktos. Latvijas Republikas Zemkopības ministrija. https://www.zm.gov.lv/public/ck/files/skaitlifakti_LV_2018web.pdf

3. Tax system — the Latvian tax system is not seen as heavily burdening, overly complicated, or obstructing smooth operation by the interviewed investors. Transparency has been named as its main advantage, whereas the lack of stability in tax legislation — as its major drawback.

The findings also show that the stereotypes regarding Chinese investments in Europe do not apply in the case of niche Chinese SMEs. First, the companies are willing to pay taxes and are not looking for ways to cut corners. Second, the investors are stating the benefits of exporting a high added value product instead of wood source material. Third, the companies are not against paying wages slightly higher than the average across this business and relying mostly on local workers. Forth, coming to a country with no prior contacts within the diaspora or among the bureaucrats, the investors prefer knocking on doors directly and establishing contacts with the relevant government agencies, instead of looking for "guanxi"[36] channels. And, fifth, the prospective investors prefer greenfield investment, albeit small in scale, over mergers and acquisitions.

Clearly, the cases reviewed for this article will not become flagbearers of Chinese investment in the region, as they are small in scale, not particularly high-tech, and the products are resource-based with a little to no element of innovation. Still, the lessons learned from the accommodation of these companies in the Latvian economy and from the feedback of the investors themselves could potentially help Latvia devise a competitive proposal for FDI — not just from China, but also elsewhere in the world.

Conclusion

Even though bigger Chinese state-owned corporations might engage in practices associated with unhealthy business behaviours in Europe, there is a case to be made in favour of Chinese small enterprises that are willing to play by the local book and can turn out to be beneficial for the local economy. Small Chinese enterprises producing high value-added products in Latvia for export, in contrary to big, state-owned and mighty corporations, might just be the most beneficial profile of a Chinese investor for the Baltic nation. Attracting small-size investors would help avoid the problems of production volume compatibility, lack of oversight typically associated with large Chinese players in the region, and risks of political pressure. It would further be the responsibility of Latvia to monitor the transparency and adherence of such companies to local laws, including taxation and environment protection. This task, however, is no different from that of supervision of any commercial actor, local or international, operating within the Latvian market.

[36] An informal network of relationship ties within Chinese society and diaspora that is being fostered with the goal of the exchange in influence services.

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