

The New Silk Road: Implications for Europe¹

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Through the New Silk Road (NSR) initiative, China increasingly invests in building and modernizing overland and maritime infrastructures with a view to enhancing the overall connectivity between China and Europe. The NSR runs through a number of Eurasian emerging markets and extends out to Southeastern Europe (SEE), where Chinese investments include the modernization of ports and highspeed rail and road projects to speed up the transport of goods between China and Europe. Given the non-negligible economic weight of Chinese investments in SEE economies, the participation in the NSR will probably stimulate SEE's economic expansion and may even contribute to overcoming its traditional peripheral position in Europe. Ideally, SEE will play a role in catalyzing a deepening of China-EU economic relations. In the long run, these developments might also influence the EU's political and economic positioning on a global scale.

¹ This note is based on the second of a set of twin studies on the New Silk Road published in the OeNB's Focus on European Integration series (Link: <https://www.oenb.at/Publikationen/Volkswirtschaft/Focus-on-European-Economic-Integration.html>). For details, see the list of references.

Why China's presence in Southeastern Europe is growing

Under the heading of “reviving the ancient Silk Road,” Chinese investments in the EU continue to grow rapidly. Chinese FDI has spread all across Europe and into various sectors, mainly the finance, infra-structure, engineering and energy sectors. In 2015, Chinese investments in Europe were concentrated mainly in the United Kingdom, Italy, France and Germany. However, particularly in the past two years, links between China and SEE have intensified, not just in financial and economic but also in diplomatic terms. Geographically, SEE (particularly Greece and the Western Balkans) constitutes the final part of China's new Maritime Silk Road (MSR, reaching Europe via the Suez Canal and the port of Piraeus, see map 1). SEE imports from China more than doubled from USD 5 billion in 2004 to over USD 11 billion in 2014. The share of imports from China rose from 3.4% of total SEE imports in 2004 to 4.6% in 2014 (Levitin, 2016, p. 5).

With a view to extending the NSR into the Balkans, China primarily invests in regional infrastructure, such as ports, railroads and highways. This strategy relies on the assumption that the countries in the region (including the Western Balkans) will catch up significantly, integrate into the EU and thus build a geo-economic bridge for Chinese companies to the main EU markets. In 2012, the People's Republic of China set up the so-called “16+1 format²” which aims at intensifying China's cooperation with 11 EU Member States (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia) and five Balkan non-EU Member States (Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro and Serbia) in the fields of transport, finance, science, education and culture. Since the first summit that brought together the prime ministers of all the 16+1 countries (“16+1

summit”) in 2012, the format has increasingly been institutionalized and China's economic presence in Central, Eastern and Southeastern Europe (CESEE) increased considerably. The last summit took place on the 27th of November 2017 in Budapest.

Europe, being the western endpoint of all major routes of the NSR, conceivably stands to gain from increased trade possibilities with a number of Eurasian countries; enhanced trade corridors with improved infrastructure are opening up new destinations for European exports. Among the 16+1 countries, the EU Member States – mainly those in Central Europe – arguably have a wider range of financing options for large investments of this sort. For SEE, where most countries (with the exception of Bulgaria and Romania) are not EU Member States, the situation is slightly different. Despite the funding possibilities offered to non-EU Member States by EU sources and international financial institutions (e.g. the Western Balkans Investment Framework), a financing gap remains (Radzyner et al., 2011). Investments from Chinese firms therefore benefit candidate countries, which cannot access large EU structural funds until they join the EU, but which are aware that their national and international infrastructure and transport links must be improved in order to make progress toward EU accession. Compared with the relatively slow process of project preparation and other institutional obstacles that must be overcome when applying for EU funding, Chinese investments appear to be a competitive alternative, as they come with streamlined approval processes, state-backed financing and rapid implementation (Sanfey et al., 2017).

The direct spillovers of these investments to the local economies may be limited however, because Chinese investors often do not employ local resources. The non-EU Member States in CESEE may partly be attractive to Chinese investors, because they could enable them to bypass EU trade laws including antidumping regulations or even environmental rules

² This The 16+1 format is coordinated by the Secretariat for Cooperation between China and Central and Eastern European Countries, which in turn is part of the Department of European Affairs at the Ministry of Foreign Affairs of the People's Republic of China.

that apply to EU Member States. A good example is the Pupin Bridge in Belgrade, constructed between April 2011 and December 2014, under the responsibility of the China Road and Bridge Corporation (CRBC). The CRBC workforce consisted of 200 Chinese workers, who were accommodated in a dormitory next to the bridge, given that the concrete had to be laid as quickly as possible and workers had to work flexible shifts on a 24/7 basis (Hollinshead, 2015). Although this may have contradicted Serbian labor, health and safety regulation, the volatility of the Serbian government and the long and difficult processes arising from stiff bureaucracy hindered any action against these conditions. The same is true for CESEE EU Member States, where Chinese projects often undermine the EU's internal market rules. The European Commission has expressed its concern about increasing trade and investment in areas which fall under EU competences, particularly for those CESEE countries which are reaching agreements without consulting the EU beforehand (see i.a. Yalcin et al., 2016). Yet, the consequences are by no means of sizeable significance to China. In any case, the local economies in such cases do not benefit greatly in terms of employment or consumption – at least in the short run. In the long-term, the SEE countries' participation in the NSR initiative will probably stimulate the region's economic growth and may even contribute to overcoming its traditional peripheral position in Europe. For Central Europe, Chinese investments implemented through the 16+1 initiative come as a welcomed strategic and financial option as populist political forces voice their disappointment about their countries' failure of catching up with Western Europe.

For China, therefore, investing in SEE is a win-win situation: As a consequence of catching up, the purchasing power of the population in SEE will increase, and as the gap in labor costs between China and SEE is narrowing too, Chinese manufacturers may find it cheaper to locate their production facilities closer to their destination markets in the EU (Hollinshead, 2015; Needham, 2014). Moreover, evidence has shown that China's knowledge of European integration is possibly somewhat

incomplete. By investing in the region, China can therefore also acquire knowledge about how to act in a highly regulated market such as the EU. Politically, Chinese investors show more readiness to get involved in countries with higher political instability and to take up the role of a neutral force and reliable business partner.

Building bridges to Europe

A strong network of ports, logistical centers and railroads will allow Chinese goods to be transported more rapidly to Western Europe and will thus intensify east-west trade. With sea shipping or the MSR being the cheapest (though not the quickest) route from the Far East to Europe, a major building block for Chinese investments consisted in buying into the Greek port of Piraeus in 2016, the first major European container port for ships entering the Mediterranean from the Suez Canal. COSCO took over 67% of the Greek state-owned Piraeus Port Authority (PPA), holding shares with a total value of EUR 368.5 million. COSCO now has management and operation rights to run the PPA until 2052 and it has already turned the port into a profitable enterprise that is now called the "Gateway to Europe." Transit time between Shanghai and Piraeus is about 22 days, which is 10 days shorter than the route between Shanghai and the northwest European ports of Rotterdam and Hamburg (Levitin, 2016, p. 2). Consequently, the duration for transporting goods from China to Europe has been reduced by one and a half weeks. In view of this cut in transit time, Beijing has already announced its plans to buy into other SEE ports such as Thessaloniki, Greece, or Bar, Montenegro.

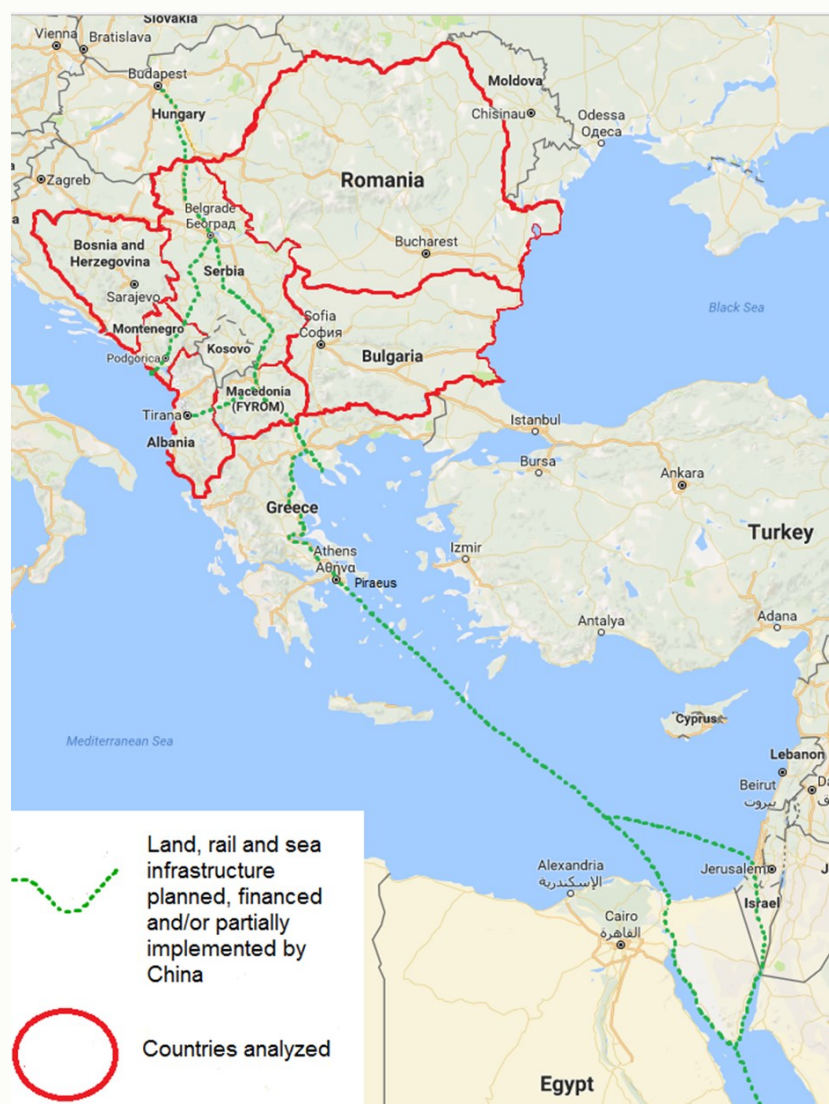
There are two important NSR land corridors that link, or are intended to link, China with Europe. First, the New Eurasian Land Bridge passing through Moscow, Warsaw and on to Duisburg already exists and is being used (particularly its rail connection, the Trans-Eurasia-Express). Second, the China- Central Asia-West Asia Economic Corridor may not only become a gateway for oil and gas but may also link up

with Europe via Turkey, once respective infrastructure connections are built (Grübler and Stehrer, 2017, p. 5). Actually, the MSR and its extension (China-Suez Canal-Piraeus-Belgrade-Budapest) and the New Eurasian Land Bridge (China-Kazakhstan-Russia-Belarus-EU) may directly link up with the Pan-European transport corridors established or projected by the EU and its neighboring countries. The cooperative modernization of these largely rail-dominated connections leading from the southeast and the east into the heart of Europe could contribute to boosting trade and connectivity both between China and Europe and with numerous neighboring emerging markets.

The rail connection between Budapest and Belgrade

(budget: EUR 1.5 billion to EUR 2 billion), decided upon in 2013, aims at reducing the travel time between the two cities from 8 hours to 2.4 hours. The plan is to further extend the route to Skopje, FYR Macedonia, and Athens, Greece. In the Balkans, the NSR will thus run along the existing Pan-European transport corridor X, which links Central Europe to the Aegean Sea via Hungary, Serbia, FYR Macedonia and Greece and is gradually being modernized. Highways and railroads are also being extended to the Adriatic coast and its ports (e.g. the highway between Belgrade and Bar). These modernization projects substantially reduce transport costs. Furthermore, Chinese companies seem to be looking into air links as well (e.g. China Everbright Group bought the operating company of Tirana International Airport).

The New Silk Road: Southeastern Europe and the Mediterranean



Source: Authors' elaboration. Original map from Google maps

How much do Chinese projects weigh economically in SEE?

The list of roads, railroads, ports, airports and energy projects in SEE implemented with Chinese investments is getting longer by the day. This raises the question of how important these investments are for the local economies in SEE. Our study lists major projects financed and carried out by Chinese investors in Albania, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Montenegro, Romania and Serbia and provides key information and data on these projects³. Based on the average gross FDI inflows for the actual project duration and for the period under observation, i.e. between 2012 and mid-2016, we estimated the listed projects' annual share in total gross FDI inflows for each observed SEE country.

The calculations show that Chinese investments certainly cannot be ignored, since their shares within total gross FDI inflows amount to as much as:

- 8% in Serbia,
- 10% in Albania,
- 26% in Montenegro and in Romania, and
- 48% in Bosnia and Herzegovina.

Interestingly, the projects identified in Bosnia and Herzegovina and in Romania, where the calculated figures are high, are mainly related to energy infrastructure rather than transport infrastructure. In the case of FYR Macedonia, the share of Chinese projects in total gross FDI inflows by far exceeds 100% (189%). This is attributable to the fact that the identified Chinese-financed projects were scheduled for two to three years only, hence we consider them one-off investments which largely exceed the size of other investments (outliers).

Summary and conclusions

In times of political uncertainty and rising nationalism in Europe, particularly those SEE countries that still have a long way to go before they join the EU will continue to look for quicker and easier financing alternatives before EU accession. Welcoming Chinese investments is part of this approach. Through the NSR or One Belt, One Road initiative, China and Europe are increasingly being linked together through the building or modernization of infrastructural trajectories which include rail, road, port, airport, pipeline, energy and communication infrastructure and logistics. With extensive financial support and experience being injected from China, roads, railroads and ports are being built or modernized in SEE in little time and without being held up by bureaucratic and legal obstacles; not to mention the fact that certain competition, tendering and procurement procedures as well as national safety and labor laws seem to be partly bypassed. In the future, more research will be needed to analyze these developments and to look deeper into the extent to which EU trade laws, tendering procedures and national regulations have been ignored so far.

The study "The New Silk Road: implications for Europe" shows that the economic weight of the most important Chinese-financed projects in the receiving SEE countries cannot be ignored. In fact, the shares of Chinese-financed projects within total annual gross FDI inflows are as high as 8% in Serbia, 10% in Albania, 26% in Montenegro and Romania and even 48% in Bosnia and Herzegovina. Since Chinese investors often employ their own workers and preferably rely on their own resources, the direct spillovers of these projects to the local economies may be limited. Nevertheless, we will be able to witness tangible effects of the NSR initiative for the

³ The list of projects is not comprehensive, as information coverage in the literature and online is incomplete, but it features the main Chinese-financed projects in the region. Not all projects listed are explicitly mentioned to be financed under the NSR initiative, but we argue that since they are cofinanced by Chinese institutions and carried out in NSR-relevant countries, they are to be analyzed in the context of the NSR.

SEE region in the near future: The modernization of rail and road infrastructures alone helps speed up the transport of persons and goods, and reduces the transportation costs within the region. SEE's participation in the NSR initiative will probably stimulate the region's economic growth and may even contribute to overcoming its traditional peripheral position in Europe. In fact, strengthened economic cooperation can only benefit all countries involved. From an EU perspective, access to EU funding for candidate and potential candidate countries will have to be improved so that investments from China are not considered attractive merely because financing alternatives are lacking. Moreover, the EU will need to work together with SEE and China to effectively use SEE's potential in a way to fulfill common interests and deepen EU-China relations. The OBOR initiative, for instance, goes beyond mere economic investments and translates into a framework for "soft power"⁴ not least through

the 16+1 initiative's wide range of activities (in education, culture, research and development).

This becomes even more important in a context where the U.S. administration has taken a protectionist stance on U.S.-Chinese trade relations and left open the future of trade negotiations with the EU. China and Europe now have the possibility to redefine their partnership and move closer together. In fact, the EU is China's biggest trading partner and China is the EU's second most important trading partner after the U.S.A. China and the EU are currently speeding up their negotiations on trade liberalization, given that European investors still face major barriers on Chinese markets. Once the conditions for European investors in China improve, Chinese FDI in Europe will also be welcomed more openly. From this point of view, the further enhancement of the NSR may truly become a turning point in China-EU trade and political relations.

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⁴ Soft power refers to the use of a country's cultural and economic influence to persuade other countries to do something, rather than the use of military power" (Cambridge Dictionary, 2017).

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