OSW | COMMENTARY
Centre for Eastern Studies NUMBER 191 | 27.11.2015 www.osw.waw.pl

China's foreign direct investments within the '16+1' cooperation formula: strategy, institutions, results

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The '16+1' formula of cooperation between the countries of Central and Eastern Europe (CEE) and China was launched in 2012. One of its priorities involved increasing the inflow of China's foreign direct investments (FDI) to the region. China has been interested in carrying out investments which are likely to help Chinese companies gain competitive advantage in areas such as advanced technologies, recognizable brands and distribution channels. The following sectors were identified as areas of priority importance in CEE: construction and modernisation of transport infrastructure, including motorways; development of the network of railways, airports and sea ports; energy, in particular renewable sources of energy and nuclear energy; companies trading in commodities; the food production sector. China's strategy mainly involves purchasing existing companies, preceded by cherry picking the most favourable candidates for investment, rather than making large greenfield investments.

Due to the involvement of the state in the process of locating investments abroad, which is typical of the Chinese economic model, stable bilateral relations with CEE partners have become key determinants for achieving these goals. In this context, the stabilisation of China's political relations with CEE observed in 2011–2014 can be viewed as a success on China's part. However, the process of creating multilateral institutions to offer substantive and financial support to Chinese companies was beset with difficulties. These included the lack of willingness on the part of CEE partners to carry out coordination tasks, the inexperience of Chinese companies in pursuing this model of cooperation, as well as failure to adjust the instruments created under this cooperation initiative to the region's economic reality. The credit line worth US$ 10 billion offered by China has been used only in infrastructural projects carried out in non-EU member states in the Western Balkans. A specialised investment fund known as China CEE Investment Co-operation Fund turned out to be more successful. However, investments carried out under this Fund in Poland, Hungary and Bulgaria are worth a mere US$ 0.5 billion. It can be expected that China will seek other models of financing its investments in the region and will use such instruments as the Silk Road Fund or the Asian Infrastructure Investment Bank (AIIB).

China's investment strategy in CEE

The creation of instruments to provide financial and substantive support to companies operating in foreign markets is typical of the Chinese foreign investment strategy. The state intervenes in the process of locating China's foreign direct investments at several levels – the strategic level, the regulatory level and by creating support mechanisms. Since 2000, which was when the Go Out strategy was implemented, initiating the era of Chinese capital expansion, China's government has been identifying priority goals of foreign investments in line with longterm development goals set out for the Chinese economy. Investments carried out in sectors indicated by specific government agencies are facilitated by various means of institutional and financial support – dedicated funds and credit lines are launched via state-owned banks[1] to offer funding on preferential terms. Companies are invited to apply for subsidies to support their operations, for reimbursement of initial costs of investments and for advisory services.

China's investment strategy in Central and Eastern Europe has been closely linked to the implementation of the 12th Five-Year Plan.

Most often these instruments are devised as a result of political agreements with states which are the recipients of these investments. At present, China's government gradually abandoning its administrative control over the process of locating foreign investments that has been applied so far, and is moving towards shaping investments by creating financial and institutional incentives. All investments whose value exceeds the limit[2] set under an administrative procedure still need prior approval by the Ministry of Trade, the National Council for Development and Reforms or the State Council of the People's Republic of China. The importance of political relations has also been boosted by the fact that a major portion of China's FDI is being carried out by state-owned enterprises. Good relations with the state which is the recipient of specific investment reduce the risk of making the transaction political in nature. To some extent, they can also influence the course of negotiations, as certain agreements can be reached at inter-governmental level.

The goals of China's direct investments in Central and Eastern Europe should be viewed in a wider context of development goals identified in the 12th Five-Year Plan for the years 2011–2015. The Plan mentions the need to acquire strategic assets to enable Chinese companies to increase their competitiveness on global markets, including by acquiring foreign companies to guarantee Chinese companies access to technology and an R&D base, to international sales channels and to recognizable brands. The task of securing the supplies of raw materials to the Chinese economy is being carried out by investing in the exploration of natural resources and in the production of foodstuffs. Another goal set for Chinese companies in the Five-Year Plan involves investments in foreign infrastructural projects, as well as offering preferential loans for projects carried out by Chinese contractors. This has been an element of a wider strategy of international development of Chinese engineering companies. The aim of this strategy element is to acquire foreign experience, to reduce the surplus in the supply of Chinese building materials and to foster the export of Chinese-made technologies, in particular in the sectors of high-speed rail and of nuclear power plants.

A detailed catalogue of sectors considered top priority[3], published by the Chinese Ministry of Trade in 2011, at the very beginning of the Chinese diplomatic offensive in the region, offers an insight into China's investment strategy in Central and Eastern Europe. The catalogue contains pieces of advice and recommendations for Chinese investors operating in 12 out of the 16 CEE states[4]. The emphasis is placed on sectors such as construction and modernisa-

[1] The investments are most frequently supported by China's four largest state-owned banks: China Exim Bank, Bank of China, Industrial and Commercial Bank of China and Agricultural Bank of China.

[2] The limit depends on the specific sector and on whether the investor company is a centrally managed state-owned company. Generally, all investments worth more than US$ 10 million require approval by a relevant body.

[3] MOFCOM, Duiwaitouziguobiechanyezhiyin (2011 ban), hzs.mofcom.gov.cn/accessory/201109/1315379855245.pdf

[4] Bulgaria, Estonia, Slovakia and Montenegro have not been included in the document.

tion of transport infrastructure, of motorways, and development of the network of railways, airports and sea ports. Another important area of infrastructure investments is the energy sector, in particular renewable sources of energy and nuclear energy. The priority sectors recommended by the Chinese government as foreign direct investment targets are different for specific CEE states. In the case of less developed economies, mainly the Western Balkan states, transactions involving the mining industry, the wood processing industry and the production of foodstuffs were recommended. Companies trading in commodities, which are frequently state-owned, were indicated as prospective objects of acquisition under privatisation projects also in other countries, including in Poland. In more developed economies, such as Hungary, Poland and the Czech Republic, the investment recommendations involved the sectors of advanced technologies, IT, automotive industry, electronics, biotechnology, nanotechnology, the precision industry, R&D centres. In several of the region's states, the sectors of advanced services and software development as well as tourism have been identified as the key sectors. The selection of sectors in specific CEE states has largely reflected the region's potential as an area in which China's goals defined in the 12th Five-Year Plan can be pursued. The focus on infrastructural cooperation, which is one of the priorities, is connected with the problem of backward and insufficiently developed infrastructure in CEE countries, as seen from Beijing's perspective. This problem has been emphasised by China. The importance of this area has also been boosted by the launch of the New Silk Road project – the development of transport infrastructure in the region has become a key issue in the context of the construction of an overland connection between China and the European Union. The remaining areas from the list of those recommended suggest that the Chinese side is interested in investments which could help Chinese companies gain competitive advantage. These investments involve technologies and distribution channels. What is interesting is that relatively competitive sectors have been selected for specific states. These include the production of lasers in Lithuania, advanced automotive industry in the Czech Republic, biotechnology and the aviation sector in Poland.

The government has identified companies which have advanced technologies and well-developed distribution channels as a priority for direct investments.

China's strategy mainly involves purchasing existing companies, which is preceded by cherry picking the most favourable candidates for investment. Less attention is being paid to large greenfield investments[5]. Documents published by China indicate that the effectiveness-based model of investments, i.e. transferring production to another location in order to optimise costs, has been much less popular with Chinese entrepreneurs than with businesses from developed countries carrying out investments in CEE.

The institutionalisation of contacts – new platforms of economic cooperation

The development of the '16+1' format in the years 2011–2014 largely reflected China's strategic aims defined at the beginning of the diplomatic offensive in the region. However, China encountered numerous barriers. These included a low level of motivation for coordinating tasks and a preference for bilateral solutions on the part of CEE states, the problems with adjusting the Chinese investment model to EU regulations and the criticism voiced by some Western

[5] This is in line with the wider context of China's investments in the European Union – according to data compiled for 2014, mergers and acquisitions accounted for 86% of the value of China's investments in the EU.

European states towards the new multilateral initiative that China pursues in CEE. All this has influenced the shape of institutions which were created in recent years to support China's investments and infrastructural projects in CEE markets. It has also limited their usefulness. Several important cooperation areas (from Beijing's perspective) have remained unexplored.

The development of the '16+1' formula in 2011–2014 reflected China's strategic aims defined earlier.

The three most significant axes of cooperation development in the years 2011–2014 were: cooperation between government agencies which offer business support, advancing the relations in the field of infrastructure and devising instruments of funding.

One of the main challenges faced by the governments of the '16+1' states involved providing substantive support and information on investment regulations to Chinese investors and their local business partners, as well as creating platforms for making business contacts. To achieve this, in 2014 two multilateral institutions were created under the '16+1' format to group business support agencies. The China-CEEC Business Council, coordinated by the Polish Agency for Enterprise Development, groups institutions from 13 states of the region and from China. Its tasks include the promotion of investment, trade and technological cooperation. A more specialised platform, the China-CEEC Investment Promotion Agencies Contact Mechanism was created in November 2014. It has been coordinated by the Polish Information and Foreign Investment Agency. It groups all 16 states of the region and deals with the exchange of information regarding investments, the organisation of training events, seminars and conferences attended by prospective investors. The biggest limitation in this type of cooperation is the low level of motivation for task coordination. CEE states have competed for direct investments from developed countries for years. Frequently, they have done so using the same government agencies which have been grouped under the '16+1' format. This is why a large portion of events and instruments targeted at Chinese investors is being created on the basis of bilateral relations which have been revived recently. Even though this can be viewed as fulfilment of some of the goals defined by China, it offers no guarantee of success for the actions China has been pursuing across the entire region.

In 2011–2014, multilateral cooperation in the field of infrastructure in the entire region was limited to joint declarations announced during annual meetings of the leaders of the '16+1' states. Strategic priorities under '16+1' included the creation of a railway transport corridor from Europe to China, the support for joint projects focused on transport infrastructure, as well as cooperation in simplifying customs procedures and in building transport hubs. In later years, the putative framework of multilateral cooperation with CEE was augmented with 'content' related to the New Silk Road initiative. The signing in December 2014 of an agreement between China, Hungary and Serbia, involving the modernisation of a railway connection linking Belgrade with Budapest, suggests that the '16+1' cooperation formula can be a useful tool for China to coordinate cross-border infrastructural projects in the CEE region. However, so far no agreement has been reached in the negotiations on the prospective creation of an institution focused on the issue of infrastructure which would group all states of the region. The absence of such an agreement seems all the more striking considering the fact that the intention had been declared during the summits in 2013 and 2014. Similarly, the stated formation of another institution of this type to deal with energy issues[6], has also ended in a fiasco. Cooperation in the field of energy infrastructure has mainly been pursued at bilateral level – China has signed framework agreements regarding cooperation in the field of nuclear energy with Romania and the Czech Republic; it has also signed a similar memorandum with Hungary.

The creation of funding mechanisms

The establishment of funding mechanisms, which is of key importance from the point of view of the Chinese model of supporting outward foreign direct investments and infrastructural projects, encountered a relatively large number of difficulties during the process of developing China's cooperation with the CEE states. When the '16+1' formula was launched by China's then Prime Minister Wen Jiabao in Warsaw in 2012, China announced the creation of a special credit line worth US$ 10 billion to be used for investments in infrastructure, modern technologies and the green economy. The launch of this special credit line, which originally was to include state guarantees of the loans extended under it, was initially confronted with legal barriers in the form of EU regulations. As a consequence, the launch was delayed. It turned out later that businesses from the CEE region were only marginally interested in this method of funding – companies and public institutions from EU states had access to more attractive forms of funding, including EU structural funds. As a consequence, in 2011–2014 the credit line made available by China was used only in infrastructural projects carried out in non-EU member states in the Western Balkans. Examples included the construction of the Bar-Boljare motorway in Montenegro, of the Mihajlo Pupin Bridge in Belgrade and of the Stanari thermal power plant in Bosnia and Herzegovina. The geographical coverage of this means of funding was largely limited, which prevented China from pursuing all its goals set for the region.

The weakness of the multilateral credit instrument created under the '16+1' formula has boosted the role of funding offered in a bilateral formula. In recent years, China's largest state-owned banks have opened foreign branches in Poland and in Hungary. By the end of 2015, the Bank of China plans to open its branch in the Czech Republic. China Exim Bank has signed several agreements regarding the support for investments to be offered jointly with local banks which implement government policy in Romania, Bulgaria and Hungary.

China encountered major obstacles in creating an investment funding mechanism which would be attractive for the region and adapted to EU requirements.

Another mechanism of funding proposed in 2012 by the then Prime Minister Wen Jiabao, a specialised investment fund operating under the name China CEE Investment Co-operation Fund, has turned out to be more successful. The initial amount at its disposal was US$ 500 million, offered to it by China Exim Bank and by institutional investors from Poland and from Hungary. In Poland, the fund successfully launched investments involving wind farms (projects Wróblew and Zopowy) and telecommunications (ECS SA). In Hungary, it invested in the education sector (the private university BKF University), and in Bulgaria – in the production of sports equipment (Walltopia). In December 2014, Exim Bank announced that a further US$ 1 billion will be made available to the fund.

From the point of view of China's strategy, the fund has managed to meet some of its initial

[6] According to the documents published after the Belgrade summit, coordination of an institution responsible for infrastructure was to be entrusted to Serbia, while coordination of energy-related matters was to be entrusted to Romania.

goals, e.g. it contributed to a diversification of China's currency reserves. However, it has failed to ensure the involvement of Chinese companies in the implementation of projects within CEE.

The shape of China's investments in the region will depend on the development of the New Silk Road project, on the development of China-EU relations and on the strategic goals defined in the 13th Five-Year Plan.

Successful operation of financial institutions of this type, which pursue an alternative model to the model of traditional credit lines offered by the government, is likely to encourage China to seek new methods of carrying out investments in the CEE region. During his visit to Belgrade in 2014, China's Prime Minister Li Keqiang announced that his country would be open to "new models of funding and investments" and that a new fund worth US$ 3 billion would be established that will explore new ways of cooperation through public-private partnerships. So far, these plans have not materialised.

The potential for development of investment cooperation

From the point of view of China's strategy to increase the scale of foreign direct investments in CEE, the biggest success of the '16+1' cooperation formula involves the strengthening of bilateral relations with the partners in the region. CEE states have boosted their efforts to attract Chinese investors, offering them substantive, legal and political support. In this way, the goals defined by China have largely been attained, although Beijing has failed to obtain a positive result regarding multilateral activities carried out across the region. Further development of multilateral economic cooperation institutions under the '16+1' formula will necessitate addressing the problem of competing for Chinese investments. This can be achieved, for example, by focusing on cross-border projects under the New Silk Road initiative.

The progress in the creation of China's mechanisms for financing of investments, combined with announcements by Prime Minister Li Keqiang during the '16+1' summit in Belgrade, suggest that China will be seeking new models to finance investments which would offer an alternative to the insufficiently used credit line. Funding instruments to be used outside of CEE, which are currently being devised by China, may serve to boost investments. Since it is located near the proposed land route of the New Silk Road, the region is entitled to use the funds available from the Silk Road Fund worth US$ 40 billion. Another source of funding could be the Asian Infrastructure Investment Bank, an investment bank which might be interested in investments located outside Asia that would be likely to stimulate Asia's growth.

Due to the fact that 12 out of 16 European states grouped in the '16+1' cooperation formula are EU members, the dynamics of China's direct and infrastructural investments in CEE also depends on the state of EU-China relations. At a political level, criticism regarding the '16+1' formula, repeatedly voiced by some Western European states, may impede the development of cooperation. The signing of a bilateral investment treaty (BIT) between China and the EU could be an important stimulus for Chinese investments in the region. In most cases, bilateral agreements between individual CEE states and China were signed more than 20 years ago and they are no longer appropriate for the current economic situation. From the point of view of the implementation of infrastructural projects, greater synchronisation of China's investment strategies in the CEE region with EU development and investment policies could be favourable to China[7]. However, the area of the real economy and the changes to the Chinese economic model, currently being implemented, continue to be issues of key importance for the inflow of China's FDI to CEE states. The main challenges for the '16+1' governments involve insufficient experience in business cooperation between China and CEE, limited knowledge of regulatory requirements and business practice among Chinese companies, and insufficient number of investment project proposals authored by CEE companies and presented to Chinese investors. Moreover, Chinese outward FDI flows are limited by structural factors – the number of CEE companies with proper technology, distribution channels and recognizable brands is relatively small. Considering the involvement of the Chinese state in locating China's foreign investments, in upcoming years the directions of these investments are likely to be shaped by new priorities governing China's investment strategy. These are contained in the 13th Five-Year Plan for the years 2016–2020 which is currently being devised. A similar role will be played by the development of the New Silk Road project.

[7] It is worth mentioning that the documents published after the meetings held in Bucharest and in Belgrade contained explicit declarations regarding the coherence of infrastructural cooperation between CEE and China with EU regulations, EU infrastructural projects and a wider agenda of cooperation between the EU and China. This introduces a pan-European dimension to the '16+1' cooperation formula; moreover, it is a consequence of strong opposition from Western European states which had initially been excluded from the project.

APPENDIX

The size of China's foreign direct investments in Central and Eastern Europe

Measurements of the flow of China's foreign direct investments are severely hampered by the significant involvement of offshore financial centres in these type of transactions, by cases of by-passing administrative restrictions imposed on capital flows using unofficial channels, and by deficiencies in statistical methodologies used. This results in a distortion of the officially published data and in considerable underestimation of the value of direct investments – this is the case for both Chinese and European sources. The data presented below has been published by the Chinese National Statistical Office and offers an insight into main trends regarding China's direct investments in Central and Eastern Europe. It should, however, be read taking account of the context described above.

China's accumulated foreign direct investments in CEE, 2007-2014, in US$ million

	2007	2008	2009	2010	2011	2012	2013	2014
Czech Republic	19.64	32.43	49.34	52.33	66.83	202.45	204.68	242.69
Estonia	1.26	1.26	7.50	7.50	7.50	3.50	3.50	3.50
Hungary	78.17	88.75	97.41	465.70	475.35	507.41	532.35	556.35
Poland	98.93	109.93	120.30	140.31	201.26	208.11	257.04	329.35
Slovakia	5.10	5.10	9.36	9.82	25.78	86.01	82.77	127.79
Slovenia	1.40	1.40	5.00	5.00	5.00	5.00	5.00	5.00
Albania	0.51	0.51	4.35	4.43	4.43	4.43	7.03	7.03
Bosnia and Herzegovina	3.51	3.51	5.92	5.98	6.01	6.07	6.13	6.13
Bulgaria	4.74	4.74	2.31	18.60	72.56	126.74	149.85	170.27
Croatia	7.84	7.84	8.10	8.13	8.18	8.63	8.31	11.87
Macedonia	0.20	0.20	0.20	0.20	0.20	0.26	2.09	2.11
Latvia	0.57	0.57	0.54	0.54	0.54	0.54	0.54	0.54
Lithuania	3.93	3.93	3.93	3.93	3.93	6.97	12.48	12.48
Montenegro	0.32	0.32	0.32	0.32	0.32	0.32	0.32	0.32
Romania	72.88	85.66	93.34	124.95	125.83	161.09	145.13	191.37
Serbia	2.00	2.00	2.68	4.84	5.05	6.47	18.54	29.71
Total	301.00	348.15	410.60	852.58	1008.77	1334.00	1435.76	1696.51

Źródło: MOFCOM, SAFE, NBS, 2015

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