GavekalDragonomics

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Beijing's Backdoor Into Europe

Tom Miller
tmiller@gavekal.com

Summary

On July 3, China and Bulgaria upgraded their bilateral relationship to a "strategic partnership." Welcoming increased investment from Chinese enterprises, President Rumen Radev said Bulgaria was "ready to deeply participate in the Belt and Road Initiative". It followed Italy's controversial decision in March to become the first G7 nation and big European economy to endorse the BRI. This was greeted with anger in Washington and dismay in Brussels. The White House rebuked Italy for lending legitimacy to China's "infrastructure vanity project." European leaders warned it was being "naïve."

Italy's decision was a diplomatic coup for Beijing. The US and EU are critical of Xi Jinping's flagship foreign-policy initiative, which they view as a simple push for more geopolitical clout. Brussels fears that Italy's involvement will deepen China's influence in Europe just as the EU is trying to limit it.

Italy is following the lead of 17 countries in central and eastern Europe, which have all endorsed the BRI. They belong to a grouping known as "17+1," a diplomatic forum in which China works closely with 12 EU member states and five prospective EU members. The current debate about China's presence in western Europe focuses on future security vulnerabilities, but China's growing clout in central and eastern Europe has been a growing concern since Beijing launched the 17+1 forum in 2012, and the BRI in 2013.

Brussels fears China is buying influence in Europe's periphery, sowing disunity and threatening democratic norms. It is accused of playing "divide and rule," deliberately picking off Europe's weakest states with promises of funds and infrastructure. But the "China threat" is exaggerated. The reality is that:

1. While China has shrewdly used the 17+1 forum to promote the BRI and sign plenty of deals in central and eastern Europe, the actual investment numbers and project delivery have been disappointing.
2. China has had more success in the Western Balkans, an underdeveloped region neglected by the EU, and its firms are engaged in a wide range of investments and projects there.
3. China's single most successful BRI investment is in Greece, where Cosco Shipping is transforming Piraeus into the Mediterranean's top container port. This example helps explain the appeal of Chinese investment for European countries.
4. Infrastructure diplomacy has bought China political support on a few foreign-policy matters, yet its impact on European politics is marginal.
5. Beijing has exploited the EU's internal divisions for diplomatic and business gains, but Brussels has the capacity to limit its influence.

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The author

Tom Miller is senior Asia analyst at Gavekal Research.

DeepChina reports

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1. Diplomatic (in)roads into Europe

As China expands its presence in Europe, alarm bells are ringing in Brussels. In addition to guzzling up European companies and technology, Chinese firms are targeting Europe's infrastructure. Huawei's rollout of the 5G network in western Europe has grabbed recent headlines, but Chinese firms also want to build roads, railways, ports and power stations in central and eastern Europe. This region holds strategic value as the endpoint of the Belt and Road.

Chinese firms want to build infrastructure in central and eastern Europe, the strategic endpoint of the Belt and Road

Taking its inspiration from the ancient Silk Road trade routes that ran from China to Europe, the BRI is Xi Jinping's signature foreign policy. Beijing presents the initiative as a series of "win-win" projects to improve connectivity, but the US and EU regard it as part of China's broader quest for global leadership. The BRI promises an alternative international development model that delivers funds and infrastructure to its participant countries, linking them more closely to China's economy while largely bypassing Western banks and firms (see **The Belt And Road To Leadership**).

The origins of 17+1

China is trying to spearhead BRI projects in Europe through the 17+1 forum. Officially called "Cooperation between China and Central and Eastern European Countries," the grouping grew out of a regional economic summit, attended by Premier Wen Jiabao, in Budapest in 2011. According to a senior ex-diplomat from Hungary who helped set up the meeting, Beijing recognized that the EU's relative neglect of the region created a business opportunity for Chinese firms. Fu Ying, China's vice foreign minister, was the force behind turning a one-off summit into a permanent diplomatic forum.

Beijing is spearheading projects through the "17+1" diplomatic forum, which includes 12 EU members

That forum began life as "16+1." It included 11 EU members (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia) and five non-EU members in the Western Balkans (Albania, Bosnia and Herzegovina, North Macedonia, Montenegro and Serbia). Greece joined the forum earlier this year, turning it into 17+1.

For China, which has built interregional economic forums across the globe, it is a familiar format. Today it is using those groupings—17+1, ASEAN +3, Shanghai Cooperation Organization, Forum on China-Africa Cooperation, China-Gulf Cooperation Council ties—to promote the BRI.

Brussels views 17+1 as a Chinese ruse to meddle in European affairs and play "divide and rule"

Brussels is wary of 17+1, which it views as a Chinese ruse to meddle in European affairs. The platform enables Beijing to hold regular summits with nearly half of the EU member states and five future members. One common trope among EU bureaucrats is that it is a "Trojan horse" to infiltrate Europe, allowing Beijing to buy political sympathizers, undermine EU unity on China policies, and project its own illiberal values. In 2017, the European Council on Foreign Relations think tank concluded there was "no doubt that the [forum] is part of a broad 'divide and rule' practice."

Plenty of promises…

China's infrastructure diplomacy is designed to open up new markets and project its economic leadership

China's infrastructure diplomacy targets countries in central and eastern Europe, which are generally poorer than other European states. The aim is to enable its state engineering firms to win contracts, gain experience abroad and foster lucrative new markets. But there is also a strategic motive: to strengthen national competitiveness, build international leverage and promote China's economic leadership around the world. This is why Beijing demands that, in addition to signing individual project deals, all BRI participants publicly endorse the initiative. Bringing EU member states on board matters to Beijing, because it gives the initiative much greater international credibility.

For Euroskeptic governments, cozying up to China in turn provides leverage against Brussels. They are dissatisfied with the pace of economic development within the EU, and resent its interference in national affairs. Czech president Milos Zeman has called for his country to become an "unsinkable aircraft-carrier of Chinese investment expansion" in Europe, while Hungary's combative prime minister Victor Orban regularly plays China off against the EU. "Central Europe needs capital to build new roads and pipelines," Orban told European leaders in Berlin last year. "If the EU is unable to provide enough capital, we will just collect it in China."

Every member of 17+1 has endorsed the BRI. The joint statement released after the forum's most recent summit, held in Dubrovnik in April, says that "participants recognize the importance of the Belt and Road Initiative [and] cooperating on relevant infrastructure investment projects." Members hope Chinese cash and engineering expertise can help them narrow the investment gap with western Europe. But the rhetoric has not matched reality: after many deals signed at summits over the years, few construction projects have materialized. Political support for working with Chinese firms remains strong—yet cancellations and delays are the facts on the ground.

… not much delivery

But its development rhetoric has not matched reality, with projects delayed or canceled

An early cautionary tale came in Poland, several years before either the 16+1 or the BRI was launched. Chinese Overseas Engineering Group, a subsidiary of the state-owned giant China Railways Group, won a tender in 2009 to build a 50 km highway from Warsaw to Germany. It submitted a bid at less than half the Polish government's budget, hoping the contract would open up other projects in EU. Yet its plan to import cheap equipment and building materials failed, and it struggled to pay its local subcontractors. In 2011, the Polish government terminated the contract and banned Covec from public tenders in Poland for three years.

From Poland to Romania to Hungary, projects backed by China have floundered

Chinese firms have shown a similar lack of follow-through in Romania, where Beijing signed an MOU in 2013 for investments topping US$10bn. At the 16+1 summit held in Bucharest that year, China General Nuclear Power Group agreed to build two reactors at the Cernavoda nuclear power plant, a project estimated to cost US$8bn. Six years later the negotiations are still ongoing, complicated by Romania's chaotic domestic politics and a disagreement with the EU over its state aid for investments. A separate project for China Huadian Engineering to build a thermal power plant in Romania was also signed in 2013, but construction has yet to start.

Most Chinese projects are in the Western Balkans

Chinese projects under construction in "17+1" countries

Project	Country	Chinese contractor	Value
Tirana-Dibra Arber motorway	Albania	China State Construction Engineering Corp.	Unknown
Banja Luka-Mliniste highway	Bosnia and Herzegovina	Power Construction Corp. of China	€1.4bn
Tuzla 7 power plant	Bosnia and Herzegovina	China Gezhouba Group, Guangdong Electric Power	US$833mn
Peljesac bridge	Croatia	China Communications Construction Co., China Road & Bridge Corp.	€651mn
Kicevo-Ohrid highway	North Macedonia	Sinohydro Corp.	€411mn
Miladinovci-Stip highway	North Macedonia	Sinohydro Corp.	€2276mn
Adriatic-Ionian motorway	Montenegro	China Pacific Construction Group	Unknown
Bar-Boljare motorway	Montenegro	China Communications Construction Co., China Road & Bridge Corp.	€807mn
Belgrade bypass	Serbia	Power Construction Corp. of China	€207mn
Budapest-Belgrade railway	Serbia	China Railway International	US$350mn
Corridor XI motorway	Serbia	Shandong Hi-Speed Group	US$344mn
Surcin-Obrenovac highway	Serbia	China Communications Construction Co.	€495mn

CSIS database, Gavekal Dragonomics research

Chinese construction companies have a much better record in the Western Balkans

The best-known BRI project in Europe is an upgrade of the rickety old railway between Budapest and Belgrade. This, too, has hit the buffers. The 350 km line is a key section of a planned freight transit corridor from the Greek port of Piraeus to central Europe, known as the China-Europe Land Sea Express

Most Chinese investment in central and eastern Europe flows to non-EU member states, where rules are more lax

Line. China signed a US$3bn deal with Hungary and Serbia in 2014, and the first freight trains carrying Chinese goods were supposed to roll into Budapest in 2017. Yet work on the Hungarian section of has not even begun.

According to a database maintained by the Mercator Institute for Chinese Studies in Berlin, China financed completed BRI projects worth only US$750mn in 17+1 countries in 2013-18, with a further US$3bn or so under construction. Using a broader definition, CSIS found that China contributed around US$15bn towards infrastructure and other investments in the 17+1 countries since 2012. A full 70% of that went to the five non-EU member states, which do not need to follow EU rules on public tendering. Most Chinese projects are located on Europe's periphery—in Serbia, Bosnia and Montenegro in the 17+1 forum, and in Belarus and Ukraine outside it.

The bilateral deals Beijing signs with its partners are typically non-binding and vastly inflate the amount of investment and construction that will follow. The MOU that accompanied Italy's endorsement of the BRI promises US$2.8bn of projects, but many projects will likely never make it off the drawing board. Outside Greece, China has made little progress building infrastructure in EU member states. The economic impact of the BRI in Europe is, so far, disappointingly small.

2. A Serbian partnership

China's infrastructure footprint is largest in the Western Balkans, which is less regulated than the EU and easier to navigate for Chinese firms. They are most active in Serbia, where Beijing's support during the Kosovo War and then its refusal to recognize the breakaway republic as an independent state sowed goodwill. In recent years, Chinese firms have made a broad range of investments in Serbia, helping to revive its struggling economy. "It would not be immodest or wrong to call Serbia China's main partner in Europe," Serbia's minister for construction declared in 2017.

Pupin Bridge

Serbia is the biggest beneficiary of Chinese investment and infrastructure building in Europe

In 2014, China completed its first big infrastructure project in Europe: the 1,500m Pupin Bridge over the mighty River Danube, on the outskirts of Belgrade. For Serbia, the €260mn bridge was a symbol of renewal: the first big project since NATO bombers devastated much of its critical infrastructure in the Kosovo War, 15 years earlier. When Premier Li Keqiang visited the Serbian capital to open the bridge, he was made an honorary citizen.

Much is made of China's "railway diplomacy," but it has generally found bridge diplomacy easier to pull off. From the Mekong to the Maldives, the world is scattered with Chinese "friendship bridges" (see **Asia's Infrastructure Arms Race**). The China-Serbia Friendship Bridge, to use its other name, was built by China Road & Bridge Corp. and largely financed by China Exim Bank at a concessionary 3% interest rate, to be repaid over 15 years. It links to the Belgrade ring road and the new southern highway, of which two sections are currently under construction by other Chinese state firms.

The Pupin Bridge has been cited in 17+1 meetings as an example of successful Chinese-built infrastructure—yet it is far from a perfect project. The procurement contracts, as with other Chinese projects in the Western Balkans, were handed to Chinese state firms with little due process. Belgrade citizens mutter darkly about project funds going missing, although they tend to blame local corruption rather than the Chinese contractor. Certainly the poor quality of the bumpy road connecting to the bridge, laid by Chinese workers, suggests that money was skimped on quality materials.

Smederevo Steel Mill

The purchase of Serbia's biggest steel mill saved thousands of jobs

Fifty kilometers downriver from Belgrade, in the old Roman fortress town of Smederevo, a Chinese firm is responsible for another symbol of national renewal: the revival of the former Yugoslavia's largest steel mill. Legend has it that when the Communist president Josip Tito visited Smederevo in the 1960s, he asked what the region was best known for. Pointed towards the vineyards sprouting from the rich local soil, he was told *grožđe*—"grapes." Deliberately or not, Tito heard this as *gvožđe*—"iron"—and instructed that a modern steel plant be built there.

By 2003, following Yugoslavia's disintegration, Serbia's only steel plant had seen better days. Bankrupt and outdated, it was sold to US Steel for US$33mn. But when steel prices plummeted after the global financial crisis, the American firm shut the blast furnaces and sold it back to the state for one dollar. With 5,000 workers on paid leave, the government frantically looked to China for a buyer. In 2016, Hebei Iron & Steel Group came to the rescue, purchasing Smederevo for €46mn. HBIS, China's largest steelmaker, pledged to invest US$300mn and double annual production.

The Serbian government views Chinese investment in critical infrastructure as vital for national renewal

Today, smoke billows once again from Smederevo's giant chimney stack. A Chinese national flag flutters at the plant entrance, near a banner proclaiming "Serbian Pride." In 2018, the plant produced nearly 2mn tons of steel and exported products worth €750mn, re-establishing Smederevo as Serbia's top exporter. In July 2018, Serbia's president Aleksandar Vucic visited. "Two years after the Chinese company became the owner of the Smederevo steel plant, this became a story about changes in Serbia, story about Serbia's success, the story about Serbia's progress," he crowed.

Kostolac Power Station

A few miles further down the Danube, near the border with Romania, Chinese cash is supporting another vital project for the Serbian economy: the US$1.25bn upgrade of Kostolac power station. State-controlled China Machinery Engineering Corp. has overhauled the plant's two existing units and is building a new 350MW supercritical coal-fired generating unit, in addition to expanding a nearby coal mine to feed it. This is being funded by a US$608mn loan from China Exim Bank, with fixed annual interest of 2.5% to be repaid over 20 years.

China Machinery Engineering is upgrading Kostolac power station

China is happy to finance new coal-fired power stations, even as others reduce funding for polluting industries

Image credit: Tom Miller

The new unit is controversial: it was not offered to public tender and will burn lignite, the dirtiest form of coal. Progress was delayed when the original environmental impact statement was ruled illegitimate. Coal accounts for more than half of energy consumption in Serbia, Kosovo, North Macedonia and Montenegro, all aspiring EU members that need to meet strict pollution regulations before they can join the bloc. The EU and international lenders are reducing coal financing, but Chinese policy banks and contractors are replacing them. Up to 3.5GW of coal plants may be built in southeast Europe with Chinese backing—including Romania and Greece, both EU member states—according to a report by the CEE Bankwatch Network.

A Balkan dance

Chinese investment is welcomed because it saves jobs and creates new ones

As political ties between both nations deepens, the list of Chinese big-ticket investments and construction projects in Serbia continues to grow. In 2018, Zijin Mining paid US$1.3bn for a 63% stake in the state-run RTB Bor copper mining and smelting complex, promising to pay off its US$200mn debt and retain 5,000 jobs. Earlier this year, tire manufacturer Shandong Linglong began construction of an €800mn plant that could eventually employ more than 1,200 people.

The newest symbol of China's rise in Serbia is an eight-story Chinese culture center under construction on the site of the old Chinese embassy, which was partially destroyed by NATO bombers in May 1999. A statue of Confucius stands outside, near a memorial thanking China for its friendship "in Serbia's most difficult hour." With language lessons and university scholarships, Beijing aims to cultivate a generation of leaders who are sympathetic to China's interests—part of its broader strategy to build pockets of influence across the world.

For Beijing, Serbia offers a useful foothold in a future EU member state

Serbia's current leaders are already firmly on Beijing's side, only too happy to provide their friends with diplomatic support in return for investment. President Vucic is a regular visitor to the Chinese capital, where he enjoys red-carpet treatment. At April's Second Belt and Road Forum, he extolled the "excellent cooperation" between the two nations and looked forward to "a strategic partnership in the future." Beijing clearly values the partnership: Xi Jinping made a state visit to Serbia in 2016, and is expected to make a second trip later this year. For Beijing, this small country offers a useful foothold in Europe.

3. Bridgeheads in the Mediterranean

China has built little infrastructure in EU member states, with one exception: Greece. Thanks to Chinese investment, the fabled waters of the Aegean Sea will soon be home to the Mediterranean's top container port. Strategically located in a natural harbor overlooked by Athens, the port of Piraeus has served the Greek capital since 480 BC, when the general Themistocles moved the city-state's navy there ahead of the second Persian invasion.

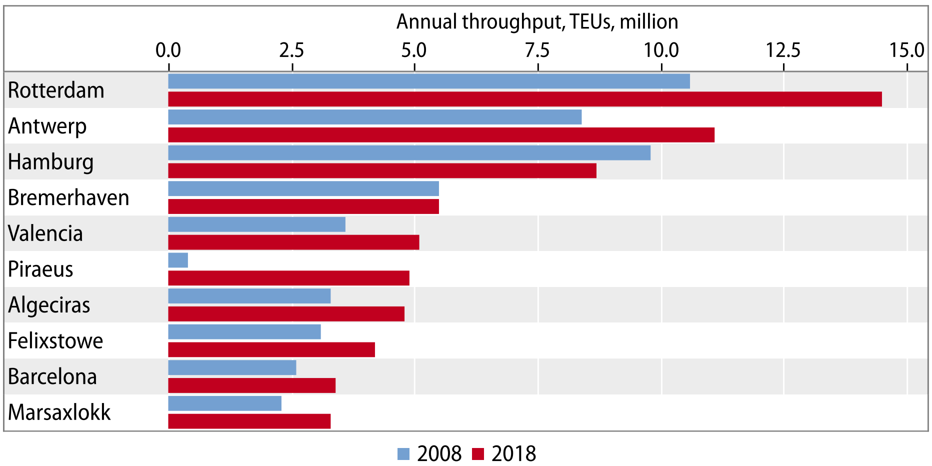
Cosco is transforming the Greek port of Piraeus into the Mediterranean's biggest container terminal

The transformation of Piraeus began long before Xi Jinping first waxed lyrical about building a new Silk Road. State-owned Cosco Shipping started sniffing around the port in 2004, but it had to wait until 2008 for the indebted Greek government to hand over a 35-year lease to operate and expand the container terminal. In 2016, the Greek government sold a 51% stake in the port authority for US$320mn, taking Cosco's cumulative investment in Piraeus to over US$1bn. Xi told the Greek prime minister Alexis Tsipras that China would build it into "the biggest transshipment port of containers in the Mediterranean Sea, the bridgehead of land-ocean transportation, and a major pivot for the Belt and Road Initiative."

The numbers speak for themselves: container throughput rose more than threefold in the decade after Cosco arrived, rising to 4.9mn twenty-foot equivalent units in 2018, propelling Piraeus into the world's top 30 container ports. This year it is expected to overtake Spain's Valencia, the Mediterranean's largest container port, which handled 5.1mn TEUs in 2018. Piraeus's expanded container terminal, with its smooth new wharfs and towering gantry cranes, has a capacity of 6.7mn TEUs. It can accommodate the new generation of "ultra-large" vessels, such as Cosco Shipping's own 400m-long Taurus, which carries 20,000 standard boxes.

Container throughput at Piraeus has grown tenfold since Cosco took over

Piraeus has risen in the ranks of Europe's biggest container ports



Port Economics, Eurostat, Gavekal Data/Macrobond

The rapid increase in throughput stems mainly from Cosco's ability to redirect its ships from other ports, but it has also attracted foreign carriers and companies. In addition to Huawei and ZTE, Piraeus serves as HP's distribution center for southeastern Europe, the Middle East and North Africa. Products are shipped by sea from Cosco's container terminal at Piraeus and by rail via the Greek state railway service operator.

Although still only half the size of northwest Europe's largest ports—Rotterdam, Antwerp and Hamburg—Piraeus is on course to become the fourth-largest container hub in Europe. "Piraeus is perhaps the best example to date of a major BRI project that is economically beneficial for both the host country and China itself," concludes Frans-Paul van der Putten in an analysis for the Leiden Asia Centre.

Budapest or bust

Planners want to build a rail freight line from Piraeus to Budapest, opening up landlocked central Europe

Planners in Beijing want to connect Cosco's shipping routes with the China-Europe Land-Maritime Express Line, establishing a freight corridor from Piraeus to landlocked central Europe. A rail service from Piraeus to Budapest via Bulgaria and Romania began in January 2018. Cosco says it shortens the delivery time for Chinese goods by seven days compared with "traditional service routes," which require goods to be shipped to the ports of northwest Europe. An efficient route through North Macedonia and Serbia to Budapest would be even quicker, cutting the standard 30-day shipping time from China to central Europe to 20 days.

With Italian ports offering more convenient access, this is commercially risky

Whether this is commercially smart is open to debate. Cosco has built Piraeus into a successful transshipment hub, but creating a viable intermodal business is another matter. "This seems to be more about China proving itself as a superpower than a commercial strategy," says Francesco Parola, a shipping expert at the University of Genoa. "It is much easier to tranship to Trieste or Marseille, which already have intermodal links. The Land-Sea Express route is unlikely to be successful, especially compared with other options."

The railway is especially controversial in Hungary. Viktor Orban's authoritarian government strongly supports the project, but has refused to make the feasibility studies public. Few economists believe it will prove profitable for Hungary. Moreover, the railway has further soured Hungary's fraught relations with Brussels. China Railway International Corp. won the original contract for the 150 km section of the line to Belgrade, with a 20-year loan package from China Exim Bank. But the EU forced a three-year delay while it investigated the deal for breaking its procurement procedures.

Construction may finally begin on the delayed Hungarian section of the railway, which has been mired in controversy

In 2017, the project was reopened for public tender. It was won by a Hungarian-headed consortium including two Chinese firms, but at a significantly higher cost than the original deal. Analysts close to the government say it is no coincidence that the consortium is led by Hungary's richest man, Lorinc Meszaros, who is a close childhood friend of Prime Minister Orban. "The railway is about corruption, pure and simple," says one critic.

Now that Orban's chum is involved, the Budapest to Belgrade section should finally be built. Work on the Serbian side is nearing completion, carried out by Chinese, Serbian and Russian engineering firms. CRBC has a contract for the southern connection to North Macedonia, although doubts about this section of the line remain. Still, if the 1,000 km link to Piraeus is completed, it will be a welcome win for China, whose global railway diplomacy has suffered a series of delays and cancelations, from Indonesia to Mexico.

An Italian job?

If Italy has its way, however, the Piraeus-Budapest line will face stiff competition from Genoa and Trieste, which are positioning themselves as alternative—and more convenient—gateways to central Europe. March's China-Italy MOU contained agreements for China Communications Construction Co. to invest in both ports. Trieste is the smaller, handling just 700,000 TEUs in 2018, but already has direct rail links to Austria, Hungary, the Czech Republic, Slovakia and Serbia. China Merchants Port Holdings, which operates 20 international terminals, is reportedly in talks to set up a joint-venture terminal there.

Italy is chasing Chinese investment as it seeks to upgrade its ports and crumbling infrastructure

The lure of enhanced economic ties explains why Italy signed up to the BRI, despite opposition in Brussels and Washington. Italy's annual GDP growth has averaged just 0.25% since 2001, as the economy has bounced in and out of recession. Rome wants to boost investment from Chinese firms, which have invested less in Italy than in other big European economies. Infrastructure spending in Italy languishes at 40% below its pre-crisis peak, even though it desperately needs to rebuild crumbling roads and bridges. Experience shows that Chinese money is no silver bullet—but Italy, like the members of 17+1, hopes it can help.

4. Europe's soft underbelly

In March, the European Commission declared China a "systemic rival promoting alternative models of governance." In its strategy document, it hinted at its frustration with China's influence in central and eastern Europe: "Neither the EU nor any of its Member States can effectively achieve their aims with China without full unity. In cooperating with China, all Member States, individually and within sub-regional cooperation frameworks, such as the 16+1 format, have a responsibility to ensure consistency with EU law, rules and policies."

Europe is beginning to take a tougher line on China, which it fears is sowing disunity and spreading illiberalism

The document was a belated attempt to address a fear voiced by Sigmar Gabriel, then German vice-chancellor, in 2017. "If we do not succeed in developing a single strategy towards China," he warned, "China will succeed in dividing Europe." The decision by all 17+1 countries to endorse the BRI, in spite of the EU's reservations, shows how tough creating a common China policy will be. Critics fear that Chinese money is already weakening Brussels' pro-market agenda, pushing newer members towards opaque, state-led deals that do not comply with EU regulations.

They further argue that, in Italy and the Balkans, Beijing is deliberately targeting what Winston Churchill termed Europe's "soft underbelly." A hard-hitting 2018 report by Merics and GPPi, two Berlin-based think tanks, outlined how Beijing is strategically using the promise of investment to buy political support in economically weaker countries. It noted, too, how illiberal leaders like Viktor Orban exploit Chinese investment as a bargaining chip against Brussels, holding up China as a strategic alternative to the EU. The report concluded that China is making an "authoritarian advance" into Europe.

Hungary's home-grown illiberalism

Critics see China's influence in Hungary, but Viktor Orban's authoritarianism is home-grown, not shaped by Beijing

Hungary is a good place to test this thesis. Here—as in Poland, Romania and the Czech Republic—a populist government threatens hard-won democratic norms. Orban, a right-wing nationalist, is a nasty piece of work: he has cracked down on Hungary's media, judiciary and NGOs, in a self-confessed drive to create an "illiberal democracy." Behind the veneer of regular elections, he runs a one-party state with no meaningful opposition. His strong endorsement of the BRI and praise of China's state development model has understandably raised fears about Beijing's influence in domestic politics.

Those fears are real but exaggerated. Orban's authoritarianism is entirely home-grown, not shaped by Beijing. He has praised the strongman regimes of Turkey, Russia and Saudi Arabia, in addition to China. He is pragmatic and opportunistic in his dealings with Beijing, but also fiercely protective of Hungary's independence. Moreover, as a youthful protester who demanded the withdrawal of Soviet troops from Hungary, Orban retains a deep distrust of Communist regimes. An adviser to a former prime minister denies Beijing is influencing domestic governance in Hungary: "Orban is not interested in importing a 'China model,'" he says, dismissively.

China's actual influence manifests itself in two ways. First, China's presence in Europe provides Orban and other anti-EU populists with greater confidence to thumb their nose at Brussels. Beijing may not interfere directly in European politics, but its investment promises do, at least in theory, provide members of the 17+1 with an alternative development partner. For countries like Hungary that oppose a federal Europe but still want more EU funds, a friendship with China can be used for political and economic leverage.

China's promises of investment have bought it support on sensitive foreign-policy issues

Second, China has effectively bought its European partners' support on sensitive foreign-policy issues. Beijing does not explicitly require 17+1 members to take its side, but several have concluded it is in their own best interests to do so. In 2016, for example, Greece, Hungary, Croatia and Slovenia forced the EU to water down its criticism of China, following the international legal ruling against China in its territorial dispute with the Philippines in the South China Sea. And, in 2017, Greece vetoed an EU resolution to criticize China in the Human Rights Council of the UN.

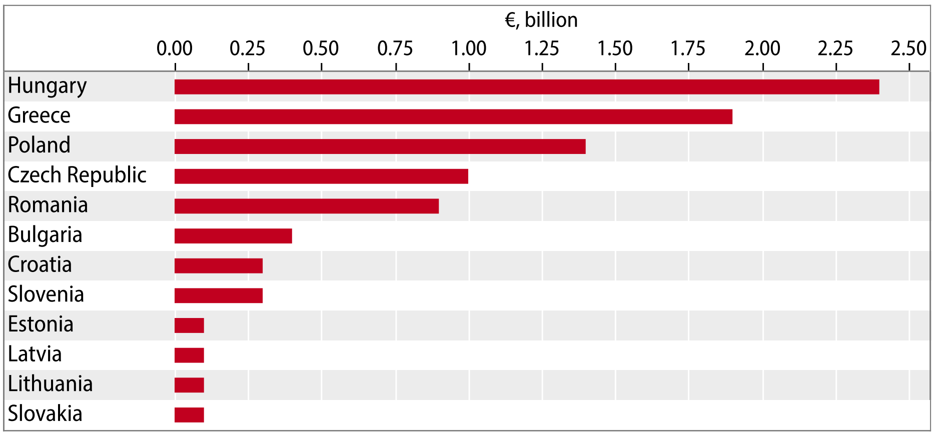
A lot of talk, not much substance

Although the relationships fostered within the 17+1 forum have proved mutually beneficial, China's economic influence on the ground remains weak. Chinese firms invested just €9bn in the 12 EU member states in 2000-18, according to a report by Rhodium Group and Merics. That compared with €47bn in the UK, €22bn in Germany, €15bn in Italy and €14bn in France. For all China's pledges, Hungary has received no substantial fresh Chinese investment for nearly a decade. China actually has a much bigger economic presence in western Europe than in the countries where it is accused of buying political influence.

But China's infrastructure diplomacy is more impressive than its economic presence, which is weak in EU members

Chinese investment in eastern Europe is still relatively small

Chinese cumulative direct investment in selected "17+1" member states, 2000-18



Rhodium Group, Merics, Gavekal Data/Macrobond

China's economic role in the region is insignificant beside Germany and other European countries. EU countries account for 70-90% of the accumulated FDI stock in Bulgaria, the Czech Republic, Hungary, Poland, Serbia, Slovakia and Romania. Daimler and Audi alone employ tens of thousands of workers in Hungary and eastern Europe; Chinese firms employ a fraction of those numbers. Nor can Chinese banks compete with Brussels's own financing mechanisms, which provide cheap loans to member states. The genius of China's infrastructure diplomacy is that it wins more attention than it deserves, given its relatively small investments and patchy record on project delivery.

Hawks in Brussels and Berlin overplay Beijing's strategic acumen

Hawks in Brussels and Berlin who worry that China is cunningly seeking to divide Europe also overplay Beijing's strategic acumen. Central authorities sign off on investments and loans, but they cannot plan and coordinate every detail of China's overseas push. China's engineering firms may be state owned and backed with funds from state banks, but they also pursue their own commercial interests, often with little central supervision. In fact, one of the great weaknesses of the BRI is a lack of oversight, resulting in feeble due diligence and commercially unviable projects (see **Assets And Albatrosses On The Maritime Silk Road**).

Finally, there is the fear that Europe's weakest states will fall prey to Chinese "debt traps"—snares set by Beijing to lure its partners into borrowing more than they can afford (see **Dangerous Dealing Along The Belt And Road**). A 2018 study by the Center for Global Development, a US think tank, cited Montenegro as one of eight BRI members at high risk of debt distress. Its experience shows that small countries outside the EU must beware becoming financially tethered to Beijing. But prospective EU member states like Montenegro and Serbia are actually in a better position than many countries to resist excessive borrowing from Beijing, as the EU provides them with institutional support and development grants to aid their accession process.

An irritant, but not a threat

China does not have enough clout in Europe to play "divide and rule"

In sum, the "influence" bought by China's infrastructure diplomacy is actually quite minor. China does not have enough clout within any European state to demand explicit political support—in contrast to the US. Instead it has bought tacit backing on a handful of foreign-policy matters. These are generally of little direct interest to its investment partners, and are not important enough within Europe to cause genuine ruptures in the EU. The refusal of a few rebel states to stand up for European values certainly annoys idealists in Brussels who see the EU as a shining beacon of the global liberal order. But it has little impact on domestic politics in Europe, let alone the lives of ordinary Europeans.

5. Continental fault lines

China is exacerbating tensions within the EU, but it is not the cause of them

Although China's diplomacy in central and eastern Europe does not amount to a policy of "divide and rule," it is exacerbating existing tensions within the EU. Brussels aims to promote policies based on shared values, but its member states have diverse perspectives and interests. Smaller countries seeking economic gains tend to be more inclined to work closely with China than larger or wealthier member states with broader strategic concerns.

The view from Budapest is instructive. When Hungary joined the EU in 2004, its citizens were sold a lie that they would catch up with their wealthy Austrian neighbors within a generation. Fifteen years on, the gap is still there; many Hungarians complain living standards have barely improved. The promise of economic renewal has instead given way to economic domination by Germany, which uses Hungary as a cheap manufacturing base. Dissatisfied Hungarians dismiss the EU as a vehicle for Germany to re-establish its traditional regional hegemony. "European values," they say, are whatever suit Berlin.

Germany's critics blame Prussian fiscal rectitude for pushing Europe's periphery closer to China. After the financial crisis, German-induced austerity forced the EU to cut its budgeted investment in new member states, forcing them to look elsewhere. With US firms uninterested and Russia neither capable nor wanted, China was the only feasible partner. "When Orban stood up in Berlin and said he would go to Beijing for cash if the EU didn't stump up, was that because of China's influence—or because he simply wanted more money?" asks one Budapest analyst.

Cozying up to Beijing is also an easy way for Hungary and other dissatisfied countries to poke Brussels and Berlin in the eye. One thing that Hungary, Greece and Italy have in common is Euroskepticism: they all feel mistreated by the EU and fear for their national sovereignty. Orban's flirtation with China is, in part, a political gambit to show Brussels that Hungary is an independent nation which cannot be dictated to. Greece occasionally sides with Beijing to prove it has an alternative to the EU technocrats who sought to impoverish it. And Italy's endorsement of the BRI came after yet another tussle with Brussels over its ballooning budget deficit.

Brussels pushes back

For the Belt and Road to succeed in Europe, Beijing needs to nurture a cooperative relationship with the EU

Ostensibly, it suits China's geopolitical interests for the EU to be divided internally and weak at projecting its policy preferences externally. But Beijing also knows that the success of the BRI hinges on nurturing a cooperative relationship with Brussels. It cannot finance and build everything on its own, and provoking an anti-China backlash will only worsen the deteriorating investment environment for its firms. Besides, many Chinese-backed projects dovetail with existing EU connectivity plans—such as the European Commission's Investment Plan for Europe, often called the "Juncker Plan," and the Pan-European Transportation Network Plan.

Beijing has made positive noises about working with the EU on infrastructure projects. Brussels has also sought to engage, hoping to prod Beijing away from predatory bilateral lending. Last year, in a direct response to the

The EU has announced its own connectivity plan to counter the Belt and Road

BRI, it launched a new "Connecting Europe & Asia" strategy to encourage "sustainable, comprehensive and rules-based connectivity." One aim is to facilitate greater lending through the European Investment Bank and the European Bank for Reconstruction and Development, as well as stepping up cooperation with the Asian Development Bank and China-sponsored Asian Infrastructure Investment Bank.

The strategy is a significant step forward, but is vague on detail. It talks about "a new external investment architecture" that "could spur public and private investment in connectivity" in 2021-27—yet this is only at the proposal stage. The EU is proposing to increase its external action budget to €123bn for 2021-27, up 30%, which would include €60bn for investment. China has welcomed the plan, because its emphasis on connecting Asia and Europe helps to legitimize the vision behind the BRI.

A new strategy in the Balkans

It is also preparing to funnel more funds into the Western Balkan states, which have turned to China to fund development

There are also signs that Brussels may finally get its act together in the Western Balkans, where China has become the biggest player in infrastructure construction. Last year, the European Commission said it would increase pre-accession funding for the five prospective member states, having provided €9bn in 2007-17. This includes more cash for connectivity projects. Serbia and Montenegro are frontrunners to join the EU by 2025.

Progress towards EU accession is vital for the bloc's interests in countries like Serbia. The long road to membership began in 1999—20 years ago—and locals shrug when asked when it will actually happen. With meager per-capita GDP of US$5,000-8,000 and little infrastructure-building capacity of their own, it is not surprising that the five Western Balkan states have turned to China. But the EU can trump Beijing simply by increasing its own assistance and announcing a firm timetable for EU membership.

Conclusion

Europe is trying to take a tougher stance on China, but its policies are inconsistent and sometimes self-defeating

Europe is finally taking a tougher stance on China, following the lead of the US. In the past year it has bolstered investment screening and labeled China an "economic competitor" and "systemic rival." Yet Europe remains conflicted on how it should treat China, which it still views as an economic opportunity. An EU-China investment treaty could be signed in 2020—a stepping-stone to creating a free-trade area. And Brussels is ready to increase cooperation with China on infrastructure projects, despite its reservations about the BRI.

The EU's China policy is muddled. Powerful voices fear that China is buying political influence in central and eastern Europe, even as Chinese firms invest far greater sums in western Europe. Carmaker Zhejiang Geely spent US$9bn on a 9.6% stake in Daimler last year—yet Italy was roundly condemned for seeking much smaller investments in its underdeveloped ports. This despite the fact that Cosco already holds large stakes in several European ports, including a container terminal at Rotterdam.

The EU's policy of unanimous voting on common foreign and security policies gives China more diplomatic clout than its economic impact warrants. Beijing needs the support of only a single member state to scupper EU resolutions. Greece and Hungary have already vetoed EU statements critical of China; when membership is extended to countries like Serbia and Montenegro, Beijing will gain more potential vetoes. If Brussels switched to a qualified majority voting system, this would limit Beijing's leverage at a stroke.

China will continue to seduce investment-hungry countries, but its influence in Europe will remain marginal

Helped by the EU's policy errors, China's infrastructure diplomacy will continue to seduce investment-hungry governments in Europe. But no EU member state views China as a genuine alternative to Brussels: it is both too geographically remote and too politically unappealing. China's position is strongest in the five West Balkan countries outside the EU, but this will weaken once they join the bloc. Beijing will go on competing with Brussels and Berlin for regional loyalties and economic influence, but only at the margin.