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**Research Report**

## Economic Policy Implications of the Belt and Road Initiative for CESEE and Austria

Policy Notes and Reports, No. 23

**Provided in Cooperation with:**

The Vienna Institute for International Economic Studies (wiiw) - Wiener Institut für Internationale Wirtschaftsvergleiche (wiiw)

*Suggested Citation:* Bykova, Alexandra et al. (2018) : Economic Policy Implications of the Belt and Road Initiative for CESEE and Austria, Policy Notes and Reports, No. 23, The Vienna Institute for International Economic Studies (wiiw), Vienna

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JUNE 2018

## Policy Notes and Reports 23

# Economic Policy Implications of the Belt and Road Initiative for CESEE and Austria

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Doris Hanzl-Weiss, Mario Holzner, Gábor Hunya  
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# Abstract

The Belt and Road Initiative (BRI), a vision to revive the ancient 'Silk Road' by means of massive infrastructure investments throughout Eurasia and Africa, was first presented by China's President Xi Jinping in 2013. China has identified the region of Central East and Southeast Europe (CESEE) as the gateway to Western European markets. This was manifested by the investment in the Port of Piraeus (Greece) and the diplomatic initiative '16+1', comprising eleven EU Member States and five Western Balkan countries, which is interesting for Austria due to its strong economic relations with this region.

The Policy Brief analyses the most recent developments in trade and investment activities of China, Austria and the EU in CESEE, which are compared to the state of infrastructure in the region in the areas of transport, energy, information and communication technology as well as finance. Overall, CESEE has a high need for infrastructure investments, particularly in the transport sector. Chinese loans and investments in the region are becoming more important, especially for the Western Balkan countries, which have limited access to EU grants. The paper concludes with seven policy areas for future cooperation between Austria and China.

**Keywords:** BRI, Belt and Road, New Silk Road, infrastructure, investment, FDI, transport, ICT, international trade, Gravity estimation, China, Austria, CESEE, Western Balkans

**JEL classification:** E22, F21, H54, F13, F14, F63, L9, O18



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# Economic policy implications of the Belt and Road Initiative for CESEE and Austria

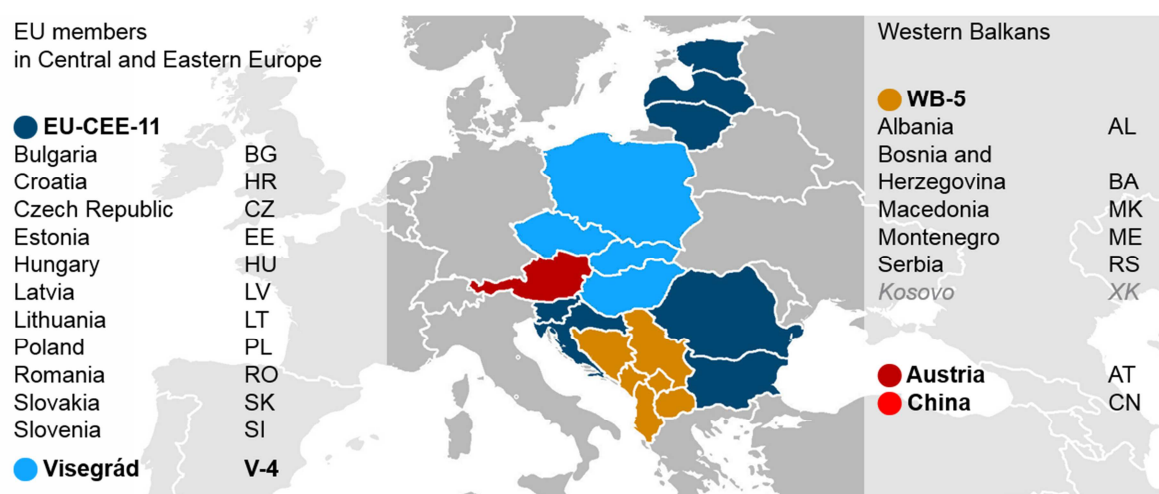
## I. THE BELT AND ROAD INITIATIVE IN CESEE

In 2013 China's President Xi Jinping announced the Belt and Road Initiative (BRI), also known as the New Silk Road, which has been prominently discussed recently. This initiative aims at the construction of infrastructure in the areas of transport, energy as well as information and communication technology primarily in Asia with an important outreach to Europe and Africa.

At its core are infrastructure investments, comprising the construction or modernisation of ports, railroad networks or motorways, gas and oil pipelines, as well as information and communication technology (ICT). Geographically it could encompass more than forty countries throughout Eurasia and Africa and affect many more, directly or indirectly. Announcements of BRI corridors and related sums of investment suggest that a strong focus lies on China's neighbourhood.

Within Europe, China seems to have identified Central, East and Southeast Europe (CESEE) as the gateway to Western European markets, and emphasised the region's strategic importance by launching a diplomatic initiative titled '16+1', with the first summit taking place in 2012 (i.e. a year before the BRI was announced). It is a country formation of eleven Member States of the European Union (EU) in Central and Eastern Europe (CEE) which entered the EU in 2004 or thereafter, five<sup>1</sup> Western Balkan states and '+1' China (Figure 1). Austria holds an observer status in the '16+1' format.

Figure 1 / Regional focus of the study



Source: wiiw.

<sup>1</sup> Kosovo is officially not part of the '16+1' initiative, yet, whenever available, we include Kosovo in our analysis.

**For Austria, due to its strong economic relations with CESEE, the BRI is particularly interesting.**

Furthermore, this region has a strong need for infrastructure investment, which forms the core of the BRI. With investments in the port of Piraeus (Greece) by the China Ocean Shipping Company (COSCO), the logical overland connection to other European countries runs through Western Balkan countries.

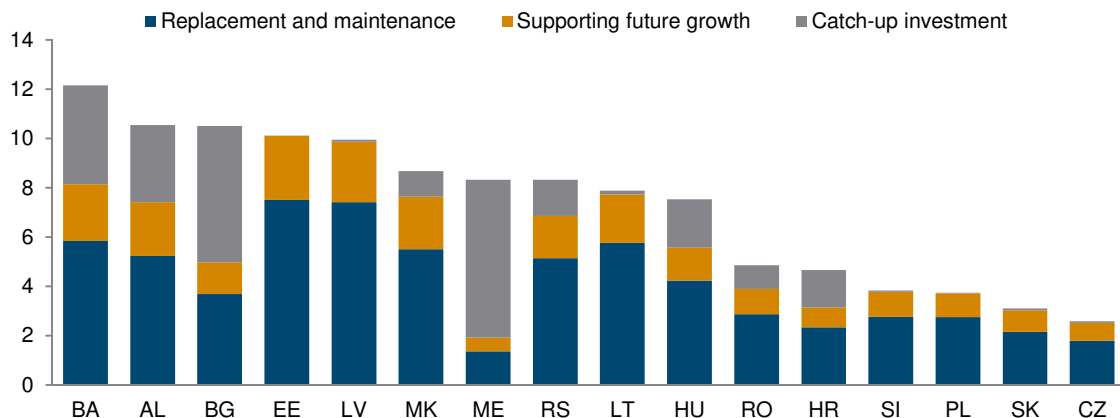
The underlying study analyses Austria's and China's involvement in the region and evaluates economic implications for CESEE and Austria in the areas of (i) infrastructure, (ii) investment, (iii) finance, (iv) ICT and (v) trade.<sup>2</sup>

## II. HUGE INFRASTRUCTURE INVESTMENT NEEDS IN THE REGION

**Overall, infrastructure investment needs are substantial in parts of CESEE-16.** While the more developed and geographically most western parts of the region (Czech Republic, Slovakia, Poland and Slovenia) have relatively small needs (mostly in replacement and maintenance) in the order of about 3% to 4% of their gross domestic product (GDP) annually over the next years (Figure 2) all the Western Balkan economies (as well as Bulgaria) and the Baltic states have substantial infrastructure investment needs in the range of 8% (Lithuania) to 12% (Bosnia and Herzegovina) of GDP, with a stronger emphasis on catch-up investment.

**Figure 2 / Substantial investment needs in CESEE-16**

Infrastructure investment needs 2018-2022 in % of GDP per year



Note: CZ extrapolated from relationship between PL and SK; all data in % of 2015 GDP at 2010 prices.

Source: EBRD Transition Report 2017-2018, own calculations.

**These needs are strongest in transport and energy infrastructure** though these differ across countries and regions. Infrastructure investment needs in ICT or water and sanitation sectors are

<sup>2</sup> Preliminary results were discussed with experts from China, CESEE and Austria at a wiiw workshop in December 2017. We thank Ms Szunomar Ágnes (Hungarian Academy of Sciences), Ms Long Jing (Shanghai Institutes for International Studies), Mr Cui Hongjian (China Institute of International Studies) and Mr Barisitz Stephan (Oesterreichische Nationalbank) for their valuable contributions.

marginal. In this respect, it is interesting to note that transport and energy are also the sectors predominantly targeted by Chinese construction projects in the CESEE-16 region.

**The importance of Chinese loans for construction projects has been increasing over time.**

Overall, Chinese infrastructure projects in CESEE make up about USD 15.2 billion (EUR 12.2 billion). More than two thirds of these have been initiated only since 2013. Geographically, the prime target of Chinese construction contracts is the central-southern part of CESEE-16. More than two thirds of the projected amounts are earmarked for construction in three countries only – Serbia, Bosnia and Herzegovina and Hungary, driven by the Budapest-Belgrade railway link. Out of the total projected construction costs about half are budgeted for energy and slightly less for transport projects.

**However, for member countries of the EU these are minor in comparison to corresponding EU grants and loans.** The EU-CEE countries benefit from major projects in the framework of the European Structural and Investment Funds (ESIF) – particularly the European Regional Development Fund (ERDF) and the Cohesion Fund (CF). The current programme period lasts from 2014 to 2020. Up to autumn 2017, a total of 464 infrastructure projects<sup>3</sup> within the EU-CEE were registered at the ESIF. Out of these, 117 projects were approved, totalling EUR 11.8 billion in EU grants. Almost 80% of the EU funds for major projects in EU-CEE are spent on network infrastructure in transport and energy.

**Chinese financing is much more significant in the Western Balkan states, which have little access to EU grants but the strongest need for infrastructure catch-up.** The EU supports infrastructure development in the region with its Instrument for Pre-accession Assistance (IPA II for the period 2015-2020). The IPA II funds earmarked for the co-financing of infrastructure investment amount to EUR 1 billion. The Western Balkan countries are also integrated in the Trans-European Network. The so-called Berlin Process aims to support the economies in the region on their path to EU membership with a special focus on infrastructure development, human capital and regional cooperation.

**Chinese construction projects are often complementary to those of the EU in the CESEE-16 region** in the sense that they are not competing for the same type of project. This is particularly true for the energy sector. However, they are sometimes opposing in the type of technology implemented (e.g. coal plants versus low-carbon economy). In the field of transport, there are more overlaps between the activities of China and the EU, particularly in the Western Balkans.

### III. CHINA AND AUSTRIA AS DIRECT INVESTORS<sup>4</sup>

**Total foreign direct investment (FDI) inflows in the EU-CEE countries were very volatile over the period 2010-2016.** There has been no sustainable recovery of foreign investment activities following the global financial crisis all across Europe including EU-CEE. As to the Western Balkans, FDI inflows were more stable over time than in EU-CEE; the setback in 2009 was smaller and the 2015-16 recovery more marked. FDI inflows in the Western Balkans comprise mainly genuine investments into new projects and less of assets restructuring between subsidiaries.

<sup>3</sup> Selected ESIF categories: Climate Change Adaptation & Risk Prevention; Environment Protection & Resource Efficiency; Information & Communication Technologies; Low-Carbon Economy; Network Infrastructures in Transport and Energy.

<sup>4</sup> The chapter draws on the wiiw FDI Report 2018 (Hunya and Schwarzhappel, 2018).

**Austria accounted for more than 12% of the total inflows in EU-CEE in the years 2011-2013** but its share subsided in later years. As Austria was a first mover investor in the region after 1990, it seems that there is not much room for further engagement in the light of the narrow specialisation and relatively small size of the Austrian economy. In the Western Balkans, FDI from Austria was quite stable, but higher in 2015 and 2016 than in the years before. The share of Austria in the region's inflow hovered around 10% on average.

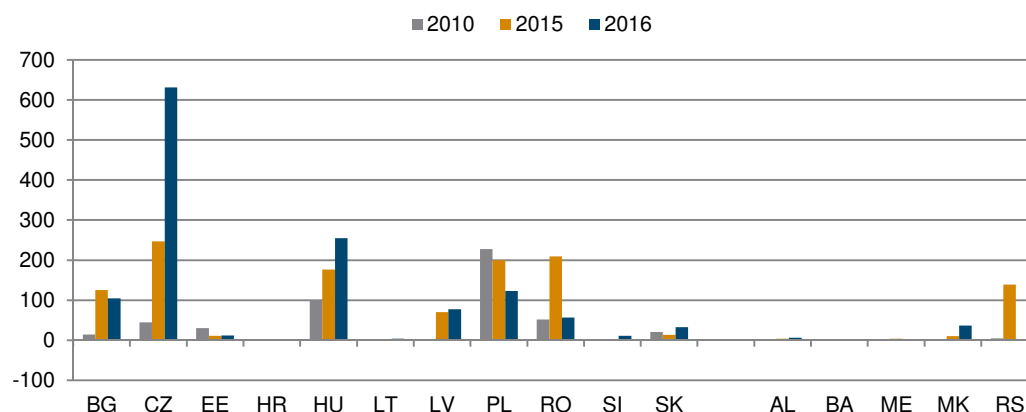
**Austria is the third-largest investor in EU-CEE and second most important investor in the Western Balkans in terms of FDI stocks.** It occupies prime positions in Slovenia and Croatia, and ranks second in Bulgaria and Slovakia, third in Hungary and Romania. It is the largest investor in Bosnia and Herzegovina and Macedonia as well as the second-largest in Serbia.

**An upward trend is observable for FDI inflows from China,** increasing from below 1% of the total inflow before 2015 to 2.6% in 2016. The main beneficiary in 2015 and 2016 was the Czech Republic, being responsible for the total upswing in aggregate inflows. Chinese investments in the Western Balkan region were almost non-existent before 2014. However, in 2016 their share was already 2.6% of the regional inflow, the same as in the EU-CEE region. The main targets of Chinese investments were Serbia and Macedonia.

**The Chinese FDI stock in CESEE reached so far only 0.2% of the total stock,** i.e. EUR 1.3 billion in 2016 (Figure 3). The host countries with the highest amounts are the Czech Republic with a stock of EUR 631 million and Hungary with EUR 255 million in 2016. In the Western Balkans, only Macedonia and Serbia report any significant FDI stock from China. China appeared in Macedonia with EUR 10 million of stocks in 2015, which grew to EUR 37 million in 2016. Investments in Serbia soared to EUR 139 million in 2015 from very low previous levels. Austria accumulated half as much FDI stock as the EU-CEE and WB region together, up from an insignificant level in the previous year.

**Direct investment statistics, however, overestimate FDI from Austria and underestimate FDI from China** as compared to the nationality of the ultimate controlling parent company. Austria functions as a bridgehead location for companies from other countries, including China, investing in the EU-CEE and Western Balkan countries.

**Figure 3 / Inward FDI stock from China in EU-CEE and WB, in EUR million**



Source: wiiw FDI Database incorporating national bank statistics of host economies.

**Looking into the motivation of investors in the EU-CEE and Western Balkan region, market seeking is generally dominating over efficiency seeking.** Selling products and services in the local market can best be achieved by taking over a company having an established market share. This has been the case with banks and companies supporting each other in accessing the EU-CEE and Western Balkan markets.

**For Chinese investors, strategic asset seeking appears as the main motivation in some of the largest M&A deals.** Investment projects provide access to profitable investment objects, new technologies and companies with established markets. Austria is an attractive economy for investors in search of technology. Chinese companies are also eager to buy assets in CESEE, but there is not much on sale especially in sectors where investors may get access to new technology. In some instances Chinese companies bought businesses that are not in good shape and in need of restructuring. Although Chinese owners are not considered as good at buy-and-fix acquisitions and post-merger integration, they may increase efforts in the future given the increasing political support to make the BRI a success.

**Chinese and Austrian FDI is partly overlapping by sectors but is found in different product groups within these sectors.** The main sectors of FDI of both Austria and China are financial intermediation, manufacturing, electricity, construction, telecommunication, IT and business services, and retail. Austrian companies have in place well-established supply chains in some manufacturing sectors, banking and retail networks, and construction companies acting throughout the region, whereas the Chinese presence is more punctual without regional supply chains.

#### IV. TRADE AND PRODUCTION LINKAGES

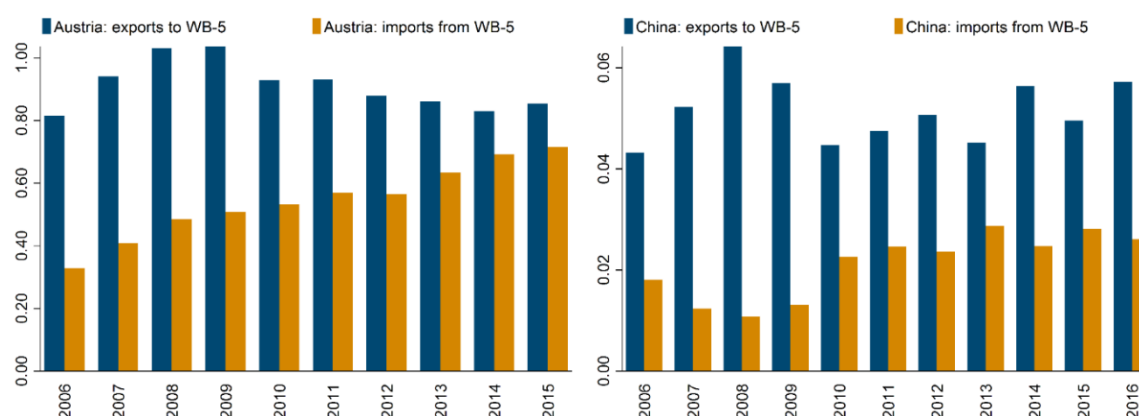
**The importance of trade flows between China and Austria has strongly increased over time.** The share of imports from China as a percentage of total Austrian imports was growing and more than quintupling over the period, reaching a level of about 6 %, i.e. more than USD 8 million, in the year 2015. Exports to China lost momentum in the early 2000s, increased after the global economic and financial crisis and have been relatively stable at roughly 2.5 % since 2011, corresponding to more than USD 3 million in 2015. China as a trading partner therefore features among Austria's top 5 import sources and among the top 10 export destinations. From a Chinese perspective, Austria also appears more important for imports (with a share of roughly 0.3% of total Chinese imports) than for exports, whose share is slowly decreasing and currently at a level of around 0.1% of Chinese exports.

**Austria's most important trading partners in CEE are located in Austria's neighbourhood:** The Czech Republic, Hungary, Slovakia and Slovenia feature among the top 5 trading partners in the EU-CEE-11, accounting for more than 10% of Austrian exports and imports in 2015. As of today, Austria imports twice as much from the EU-CEE-11 than from China, but exports more than six times as much to the EU-CEE-11 than to the Chinese market. The share of Austrian imports from Central and Eastern European EU Member States increased from 7% in 1995 to more than 10% in 2006 and further to currently 14%. The proportion of Austrian exports to the region rose from 12% in 1995 to a maximum of almost 19% in 2008. Since then its importance has remained stable at a level of roughly 17%, with a slight upward trend since 2013.

**While CEE trade relations with Austria are already very strong, trade ties with China seem to evolve just now.** We observe a steady increase in the share of Chinese imports from the EU-CEE-11, but a recent slump in the share of exports. Although the economic crisis was a global phenomenon, the declining shares indicate that import demand of EU-CEE-11 was affected over-proportionately.

**The picture is quite different for Western Balkan countries, where China plays a prominent role also as an export destination.** China is a top 5 source of imports to every country in the region, with shares ranging from 6.2% for Macedonia to 9.3% for Kosovo. What marks the great difference to the trade relation with the EU-CEE-11 is that China also features among the top 10 export destinations for Albania and Kosovo and is even listed among the top 5 for Montenegro. From the Austrian and Chinese perspectives, trade volumes with the WB region are significantly lower and more volatile than trade flows with the EU-CEE-11.

**Figure 4 / Evolution of AT/CN trade relations with the Western Balkan region, in %**



Source: UN Comtrade. Note: wiiw-visualisation.

**Figures on arrivals and overnight stays point towards the growth potential for the tourism sector.**

During the period 2000-2016, shares of arrivals from the EU-CEE-11 and the Western Balkans to Austria were doubling to 9.8% and 0.5%, respectively. Chinese tourists have only recently started to discover Austria as a travel destination, but shares are quickly increasing and almost tripled during the last 10 years from 0.9% to 2.6%. Good diplomatic, investment and trade ties can foster this trend. Assuming that BRI investments in CESEE increase connectivity and income in the region, Austria might experience a continued influx of visitors from eastern and southeastern parts of Europe.

## V. HOW COULD THE REGION BENEFIT?

**There are multiple risk factors and a great deal of uncertainty fuelling public fears regarding China's actions in Europe.** These include discussions on debt sustainability, a potential increase of corruption, political influence resulting from financial dependency and disappointment with economic effects if local contractors, suppliers, materials and workers are not involved in the implementation of projects.

**Notwithstanding the risks, the report points towards short- and medium- to long-term positive economic effects of the BRI in Europe.** The largest direct economic effects are triggered by Chinese infrastructure projects and indirect effects attributable to subsequent increasing trade flows. An infrastructure investment in a specific country first triggers direct demand for products in the construction industry of that country. As, however, this industry needs inputs from other industries, which are partly sourced from industries in other countries, such an investment also generates demand and therefore production and income in the trading partners. Since each industry in each country itself has to source its production from other industries and countries, these direct effects trigger again demand for products in further industries and countries. Infrastructure investments in one country can therefore result in indirect effects for many more countries.

**The actual impact largely depends to the extent these investment funds actually turn into real investment demand** and thus trigger an increase in demand of the construction industry. Further, such huge infrastructure projects are not going to be implemented and conducted within a single year. As such, the (direct and indirect) effects of such infrastructure investments spread over a couple of years, with a certain amount of direct and indirect production and income effects being generated in each year. The results shown in Table 1, which also lists the funds available for investment, are to be interpreted as the cumulative GDP impact of all investments over the years of implementation.<sup>5</sup>

**In a ‘business as usual’ scenario the effects of Chinese infrastructure projects are highest at more than 10% of GDP for Montenegro and Bosnia and Herzegovina, at around 7% for Serbia and still above 2% for Macedonia.** In the calculations we assume that countries source the products and services they need for the realisation of infrastructure investments as they did in the past. The impact on EU-CEE-11 ranges from very low levels for Baltic countries at around 0.02% of GDP to more than 1% for Hungary. These effects would materialise over several years, depending on the speed of project implementation. Further medium- to long-term effects might result from the reduction of transport costs and time, the diversification of traded goods and firms engaging in international trade as well as potential inter- and intra-regional cooperation.

**There are some sizeable effects in other countries which have strong trade linkages with the region like Austria (as well as Germany or Italy).** For these countries the cumulated GDP effects would amount to USD 2.5 billion in Germany, 1.2 billion in Italy, and 0.5 billion in Austria, though the impact relative to GDP is typically smaller, e.g. 0.11% in the case of Austria. China would profit from these investments (via the production networks) to the extent of USD 1.4 billion, though the impact relative to GDP is small given the size of the country.

**The impact might even be larger when further induced effects are taken into account.** These would increase the GDP effect even further by a factor of 1.3 to 1.4 for the EU-CEE countries. Interestingly, the effects are higher for the main sourcing countries Italy and Germany (for which this factor is about 1.9) and Austria (with a factor of about 1.8). The effect is particularly strong for China where the induced income raises the GDP effect by a factor of 3 (though still remaining rather low at 0.04% of GDP).

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<sup>5</sup> Specifically, the simple Leontief-type demand-driven input-output model does not capture further effects of likely changes in productivity or trade and transport costs which would further boost GDP.



**Table 1 / Estimated cumulated GDP impacts of infrastructure investments**

	in million USD				in % of GDP			
	China	EU grants	EU loans	Total	China	EU grants	EU loans	Total
Montenegro	558	118	310	986	13.72	2.89	7.64	24.25
Bosnia and Herzegovina	1840	183	1659	3682	10.52	1.05	9.49	21.06
Serbia	3036	212	2508	5757	7.30	0.51	6.03	13.85
Albania	6	107	1158	1272	0.05	0.82	8.83	9.70
Macedonia	273	40	672	985	2.46	0.36	6.06	8.88
Croatia	425	1302	342	2069	0.78	2.39	0.63	3.80
Romania	1805	3714	192	5711	0.90	1.85	0.10	2.85
Poland	861	12829	1135	14826	0.16	2.30	0.20	2.66
Hungary	1657	1350	94	3101	1.16	0.94	0.07	2.16
Bulgaria	72	1021	67	1160	0.13	1.78	0.12	2.02
Slovak Republic	85	1539	510	2134	0.08	1.42	0.47	1.98
Slovenia	151	634	178	963	0.30	1.27	0.36	1.93
Lithuania	7	609	316	932	0.02	1.20	0.62	1.84
Latvia	76	376	77	529	0.24	1.20	0.25	1.69
Estonia	4	297	38	339	0.02	1.12	0.14	1.28
Czech Republic	173	1390	144	1708	0.08	0.63	0.07	0.78
Austria	170	200	126	496	0.04	0.05	0.03	0.11
Germany	673	1418	490	2580	0.02	0.04	0.01	0.07
Italy	378	443	350	1170	0.02	0.02	0.02	0.06
China	380	660	340	1380	0.00	0.01	0.00	0.01

Note: Countries are ranked by size of impact on GDP.

Source: wiiw calculations based on ESIF, CEF, TEN-t, WBIF and EFSI data on EU grants and loans and the China Global Investment Tracker for Chinese construction project.

**However, the impact on the region and neighbouring countries might be lowered if investments are mostly implemented by Chinese firms which use their own production networks.** In this case the impact on China would be stronger. Assuming that 50% of the investments due to Chinese funds are using Chinese production networks for construction, demand would imply that the GDP effects (out of Chinese investment funding) would be halved for the EU-CEE countries and their trading partners (e.g. Austria, Germany, and Italy) whereas for China the cumulated effect on GDP increases to 0.06% (compared to 0.01% as reported in Table 1).

## VI. SECTORAL DIMENSIONS

**For the realisation of infrastructure projects as well as for the expansion of trade and foreign direct investment, the availability of adequate financing and capable information and communication technology (ICT) infrastructure is a necessary prerequisite.** In fact, in the BRI as well as in the '16+1' initiative, financial cooperation is one of the major fields and actually stands at the beginning of each project. Branches of Chinese banks are present only in a number of countries in the region. Overall, their presence is small and they have been established only recently. Preferred targets have been Hungary, Poland and also the Czech Republic and Serbia.

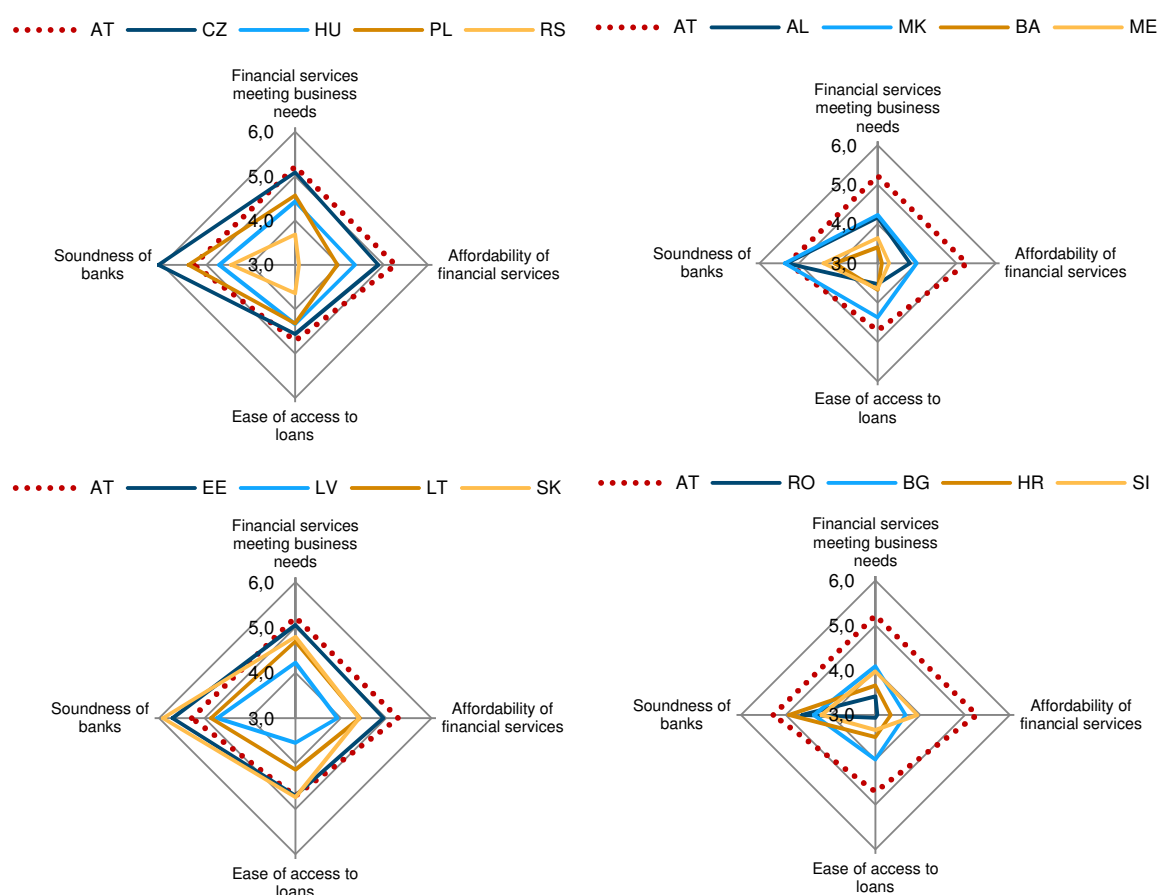
**The information and communication sector is very dynamic in the region,** growth rates being double those of GDP in the period 2010-2016 in the CEE-11 and Macedonia. However, targeting the ICT infrastructure is less prominent in the BRI as well as in the '16+1' initiative, and projects are still rare.

Overall, in two major sectors – the financial services and the information and communication technology sectors – Austrian involvement in CESEE is strong and started early. Chinese banks have entered the region only recently, also fostered by the ‘16+1’ initiative. Chinese investment in communications focuses on communications equipment. Thus, in these two fields China could likely benefit from Austrian expertise and knowledge in the region.

**Some countries’ financial sector development is still struggling with the effects of the crisis.**

Figure 5 shows four sub-categories of the financial market development indicator: financial services meeting business needs, affordability of financial services, ease of access to loans, and soundness of banks. Countries are grouped according to those with Chinese branches (the Czech Republic, Hungary, Poland and Serbia) and those without (CEE and Western Balkan countries) with Austria shown as a reference. Differences occur within the region, with the Czech Republic, Slovakia and Estonia showing a better development of financial markets, while Bulgaria, Romania, Croatia, Slovenia not performing well.

**Figure 5 / WEF Competitiveness Indicator, financial market development**



Source: World Economic Forum (2017).

**There are several funds established serving to finance the Belt and Road Initiative, which are of relevance for the CESEE-16 region.** The Silk Road Fund has a total capital of USD 40 billion. It is primarily operating through equity investment, supporting infrastructure, resources and energy development, industrial capacity cooperation and financial cooperation. As of March 2017, contracts of

15 projects were concluded, with an investment commitment of about USD 6 billion. The Asian Infrastructure Investment Bank (AIIB) is a multilateral development bank with an authorised capital of USD 100 billion. As of end-2017, it had approved 24 projects with a sum of USD 4.2 billion. The New Development Bank (NDB) founded by the BRICS countries (Brazil, Russia, India, China and South Africa) is a multilateral lending institution that became operational in 2016 and has an initial authorised capital of USD 100 billion. It is active in renewable energy, transportation and social infrastructure. Between 2016 and 2017 loans were approved involving financial assistance of over USD 3.4 billion in all member countries. Chinese banks committed to the Belt and Road Initiative include the Export-Import Bank of China (China EXIM Bank), the China Development Bank (CDB) and the Agricultural Development Bank of China (ADBC). Amounts allocated to the initiative are said to be the following: USD 30 billion China EXIM Bank, USD 32 billion CDB and USD 20 billion ADBC (Barisitz and Radzyner, 2017).

**Further financial cooperation is a top priority of the '16+1' initiative.** The main points discussed at China-CEE Summits include special credit lines and the China-Central and Eastern Europe Investment Cooperation Fund (China-CEE Fund). Existing projects in the region have usually been funded from the state-owned Export and Import Bank of China. They mostly cover 85% of the necessary capital, while the other 15% come from the local government or other local investors. Usually, these loans have a long maturity of about 20 years and low interest rates (about 2%). They are normally contracted in US dollars (Levitin et al., 2016).

## VII. THE WAY FORWARD

The biggest official visit in the history of Austria took place in China in April 2018. The wish for further and intensified bilateral cooperation between Austria and China was expressed in multiple Memoranda of Understanding (MoU). These include a MoU on the BRI between the Austrian Ministry for Transport, Innovation and Technology (BMVIT) and the National Development and Reform Commission of China, as well as MoU on research and innovation, modern trade, cultural exchange, intellectual property rights or an action plan for the period 2018-2020 between BMVIT and the Ministry for Transport of China.

**Having the increased diplomatic efforts and visions of the MoU as well as Xi Jinping's report at the 19<sup>th</sup> CPC national congress in mind, we conclude our report with seven policy areas for future cooperation between Austria and China. All recommendations are economic in nature and need to be subject to a proper impact assessment including social and environmental considerations.**

### #1: Cooperation in multimodal transport infrastructure development

One infrastructure project with Austrian and Chinese participation being publicly discussed is the extension of the Russian broad gauge railway from eastern Slovakia (where it currently ends) all the way to eastern Austria, with the long-run aim of a daily train connections between Austria and China. However, earlier ambitious plans to have regular train connections between China and Slovakia have failed so far. A more realistic project is the modernisation of the rail infrastructure along the route from the port of Piraeus via Belgrade and Budapest to Vienna, which was mentioned in a MoU between the two countries at the recent visit of an Austrian delegation to China. In the wake of this visit also an increase in air connections between the two countries was envisaged. This would be a small but realistic step towards improved connectivity.

A project that could create demand for future transport infrastructure could be the establishment of a joint logistics hub, located for instance somewhere between Vienna and Bratislava, well in advance of more powerful transport routes (such as the broad gauge rail extension) while making use of current land, river and air transport capacities. The broader metropolitan area of Vienna and Bratislava is one of the wealthier regions in Europe (upper quarter of the distribution of GDP per capita in EUR) with a considerable potential for further growth and has a joint population of about 3.5 million inhabitants, making it one of the top 20 metropolitan areas in Europe. A major advantage is the central position within the EU, at the crossroads of major transport corridors as well as the Danube, Europe's second largest river. The logistics hub could include the development of additional river harbour facilities and rail connections as well as warehouses. With a view to further increasing trade volumes, the project could be complementary to the cargo hub in Budapest, which currently absorbs a large share of freight from China.

## **#2: Tourism as an opportunity for business and cultural exchange**

Over the last decade, the share of foreign guests in Austria arriving from China tripled. During the year 2017, it further climbed to 3.0%, ranking among the top 10 countries. There is, however, still untapped potential, particularly when contrasted with the number of nights, which only represent 1.2% of all overnight stays of foreign visitors, resulting from a very low average number of 1.4 nights per stay. Policy areas to unleash the potential include:

- (i) Visa facilitation: Negotiations on the European level were launched in May 2017.
- (ii) More frequent flights between Austria and China: Direct flights currently exist between Vienna and the two mainland metropolises Beijing and Shanghai, as well as Hong Kong. In the course of the Austrian official visit to China, an additional direct flight between Shenzhen and Vienna by Hainan-Airlines starting in October 2018 was announced.
- (iii) Opening Trans-Eurasian railway to tourism: Multiple railways between eastern parts of China and Western Europe (e.g. London or Madrid) are already operational, yet, so far only for freight trains. Following the examples of the Trans-Siberian railroad from Moscow to Vladivostok or the Orient Express from Paris to Istanbul, a railway network stretching all over the Eurasian continent bears potential for tourism.
- (iv) The establishment of tourist attractions of common interest: The continuation of the giant panda breeding and research project, started in 2013, is one of the best examples showing the synergies between diplomatic efforts, cooperation in the field of research, species protection and business, through the attraction of domestic and foreign tourists. Within China, tourist attractions of interest to both countries could be winter sport resorts. Austria has worldwide renowned experience in establishing resorts, providing infrastructure for winter sports, such as cable cars, ski pass hardware and software, and – particularly interesting for China's many relatively dry skiing regions – infrastructure for the production of artificial snow. In addition, Austria has expertise in alpine accommodation and catering (e.g. ski lodges and huts) as well as in setting up and running skiing schools.
- (v) Promotion of diversity: China is more than Beijing and Austria is more than Vienna. However, city tourism is strongly dominating bilateral tourism flows. Currently, two thirds of Chinese tourists visit Austria during the summer season and primarily cities such as Vienna, Innsbruck and Salzburg.

Both, the EU-China Tourism Year 2018 as well as the upcoming Winter Olympic Games in China in 2022 might accelerate bilateral tourism and change its structure.

### **#3: Setting a level playing field for trade and investment**

In 2013, the year when the BRI was announced, the EU and China launched negotiations for an Investment Agreement aiming at attracting and protecting investors to EU and Chinese markets and at securing access to both markets. The 16<sup>th</sup> round of negotiations took place in Brussels from 12 to 15 December 2017. The 17<sup>th</sup> round was scheduled for mid of April 2018 in Beijing. According to the European Commission, negotiations have advanced in areas such as expropriation and transparency but are in an initial stage regarding sustainable development or financial services.

On the one hand, the implementation of the BRI seems to gain speed throughout Eurasia and Africa, while on the other hand, growing mistrust and fears associated with Chinese investments are voiced by the European public, in particular regarding public procurement procedures and the involvement of Chinese firms and workers in BRI projects. In the interest of both the EU and China, Austria could and should take the opportunity during its presidency of the Council of the European Union to push for:

- (i) A successful and mutually beneficial conclusion of the Investment Agreement: A rule-based bilateral relationship built on the principles of non-discrimination and reciprocity enforceable by a common dispute settlement mechanism improves transparency and should increase trust of Chinese and EU investors and hence investments.
- (ii) A revival of negotiations of a trade agreement: Although trade is of crucial importance for both parties, the negotiations on an upgrade of the 1985 Trade and Economic Cooperation Agreement that started in 2007 were again stopped in 2011. With China's accession to the WTO in 2001, the WTO framework is the core basis for EU-China trade relations and dispute settlement. A new generation of trade agreement extending from tariff reductions to the fields of non-tariff measures and product standards could increase consumer confidence in product quality, thereby reducing the public concerns raised in the context of a possible trade increase with China resulting from BRI infrastructure investments.
- (iii) A BRI evaluation and communication strategy: Both the EU and China have an interest in the BRI being successful as a development project for economic, political and security reasons. Key to its success will be transparency and communication to the public: Which projects are planned and which have been implemented so far? How much local employment was generated? How did transport times and costs improve? To inform the public requires political will but also continuous research and case studies. Building on a more than 30-year partnership in scientific-technological cooperation and on more than 15 years in the field of cultural exchange, Austria and China might envision to deepen cooperation by setting up a research hub for the evaluation of BRI in Europe, particularly in CESEE.

### **#4: Chinese-Austrian Central European E-automotive Hub**

Foreign investors in the CESEE-16 form an automotive production hub. They are eager to maintain their position in times of electric mobility. Volkswagen, Audi and others are about to start the production of e-cars in their existing production sites. Asian battery producers including Chinese ones have entered

the region with new production facilities to participate in the e-car development programmes of carmakers.

Austria is an advanced location for the development of e-mobility technology and can play a leading role in Chinese access to the region based on expertise and skills in the field. This is why Great Wall Motor opened an R&D centre in Austria in January 2018 that will develop electric motors and related control systems by investing EUR 20 million by 2020. Magna Steyr announced in April 2018 to cooperate with Beijing Automotive Industry Holding Co., Ltd. (BAIC) in developing intelligent electric vehicles. Magna has several manufacturing facilities beyond Austria (Czech Republic, Hungary, Poland, Slovakia, Slovenia) which could be turned, over time, into a network of production sites for e-car components. Magna's experience in managing multi-site production, development and cooperation systems in the region can facilitate the entry of Chinese producers and technology developers into existing and new value chains focusing on e-mobility. The Austrian and Chinese governments could support private cooperation initiatives by organising high-level events together with the respective business community. In the case of e-mobility this could involve also suppliers from neighbouring Central and East European countries.

#### **#5: Cooperation in ICT in the early stage**

It seems that cooperation in the transport sector is more advanced than in telecommunications. Only in the Bucharest (2015) and Belgrade Guidelines (2014) it is mentioned 'to support closer cooperation in information and communications technology'. However, Chinese investment in the ICT sector is taking place, as revealed by our analysis. Also the WKO (2018) points towards Chinese interest in telecommunications/electronics, yet only in two cases the WKO sees opportunities for Austrian involvement/cooperation: In Slovenia, the strong presence and high reputation of Austrian investors may prove Austrian enterprises as excellent partners for cooperation. In Romania, there might be links between enterprises in activities of telecom equipment suppliers (not yet achieved).

Overall, it seems that the ICT sector is not a priority area in the '16+1' framework but might be further promoted. There might be cooperation possibilities between telecommunication service providers and suppliers, on the one hand, and telecom equipment providers – which are large Chinese enterprises – on the other. The new Austrian strategy on 5G broadband expansion – made public as of end of April 2018 – also seems to seek cooperation with other countries. As China is a frontrunner in 5G development, cooperation possibilities might exist. However, the right definition of cooperation has to be kept in mind, which should not mean competition in the end. Collecting information from relevant actors on both sides, exchanging this information, and bringing relevant actors together (e.g. in a conference setting) might create further cooperation opportunities.

#### **#6: A Sino-Austrian investment bank for the Western Balkans**

Vienna is the financial centre of Central, East and Southeast Europe. Hence it is useful to think about possible cooperation between Austria and China, also in financial issues. Plans of the world's biggest commercial bank, the Industrial and Commercial Bank of China (ICBC), to implement a regional headquarter in Vienna are protracted and the issuance of a bank licence has been under examination by the European Central Bank for about a year. Apart from commercial financial activities in the region, also common financial activities pursuing public interests should be considered.

One suggestion would be the establishment of a Sino-Austrian investment bank for the economically weakest part of the 16+1 region – the Western Balkans. Despite a number of financial organisations active in the wider region, there could be a niche for an investment bank that specifically targets infrastructure investments in the common interest along the line Piraeus–Vienna as well as the respective cross-connections along the route. Given the small size and low level of economic activity of the countries in this sub-region, the efforts would be manageable but the gains might be significant. Currently, a number of Chinese financial organisations (or organisations with Chinese participation) are active in the wider region: e.g. the Silk Road Fund, the China-EU Co-Investment Fund, the China EXIM Bank or the China Development Bank. On the part of the EU, several institutions providing grants and loans are financially active in the region as well. The European Investment Bank is only one example. More specifically, the Western Balkans Investment Framework (WBIF) supports socio-economic development and efforts towards EU accession across the Western Balkans through the provision of financial and technical assistance. A wide range of projects are being supported, infrastructure is one of them. Hence, a more specialised institution focusing on transport infrastructure in the Western Balkans, which is in the interest of both China and Austria, could be a valuable tool to be considered.

#### #7: Austrian pupils learn Chinese

Finally, what could add to a good partnership if not the ability to speak the same language? Our last policy recommendation is to start Chinese language teaching in a large number of schools throughout Austria as a second foreign language. Currently, only a few schools offer Chinese as an optional subject. In 2016, the first ten grammar school pupils had their school leaving examination also in the subject Chinese. An extensive network of Chinese teaching throughout Austria could yield a critical mass of Austrians speaking Chinese. The Chinese government could help Austria to develop the respective teaching capacities in this important subject. This could for instance involve teacher training and exchange programmes.

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Herausgeber, Verleger, Eigentümer und Hersteller:

Verein „Wiener Institut für Internationale Wirtschaftsvergleiche“ (wiiw),  
Wien 6, Rahlgasse 3

ZVR-Zahl: 329995655

Postanschrift: A 1060 Wien, Rahlgasse 3, Tel: [+431] 533 66 10, Telefax: [+431] 533 66 10 50  
Internet Homepage: [www.wiiw.ac.at](http://www.wiiw.ac.at)

Nachdruck nur auszugsweise und mit genauer Quellenangabe gestattet.

Offenlegung nach § 25 Mediengesetz: Medieninhaber (Verleger): Verein "Wiener Institut für Internationale Wirtschaftsvergleiche", A 1060 Wien, Rahlgasse 3. Vereinszweck: Analyse der wirtschaftlichen Entwicklung der zentral- und osteuropäischen Länder sowie anderer Transformationswirtschaften sowohl mittels empirischer als auch theoretischer Studien und ihre Veröffentlichung; Erbringung von Beratungsleistungen für Regierungs- und Verwaltungsstellen, Firmen und Institutionen.

