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THE PEOPLE'S REPUBLIC OF CHINA CONNECTING EUROPE?

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Abstract

The significance of the Belt and Road Initiative (BRI) of the People's Republic of China (PRC) for Europe is increasing. The diplomatic initiative "16+1," comprising 11 Central and East European EU member states and five Western Balkan economies, expanded to a "17+1" format in April 2019, when Greece officially joined the cooperation forum. In relative terms, the Western Balkans are expected to benefit the most from the BRI, as they show particularly high deficiencies in infrastructure and to date have limited access to EU grants. The economic effects of infrastructure projects in CESEE would, however, trickle through European production and supply chains, with an impact on economies not directly subject to construction plans. EU initiatives presented in 2018 may help to increase complementarity between Chinese and European infrastructure development plans, as well as reducing risks for some European economies, such as unsustainable debt or the rise of new barriers resulting from increased competition for Chinese investments. The BRI is about to change physical and digital connectivity within Europe, while the EU has yet to become an active player engaging in the initiative, in order to enable improved connectivity in Europe to drive economic convergence and not political divergence. The need to establish a level playing field for trade, investment, and its financing has become even more urgent, with the United States undermining multilateralism and adopting a noncooperative stance towards the EU and an openly hostile position towards the PRC.

Keywords: Belt and Road, infrastructure, connectivity, EU, People's Republic of China (PRC), Western Balkans

JEL Classification: E22, H54, F14, F21, L91, O18

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1. THE NEW "17+1" IN EUROPE

Announced in 2013, the Belt and Road Initiative (BRI) of the People's Republic of China (PRC) [1] has become a global project that is extensively discussed by politicians, academics, and the public. It aims to expand and develop infrastructure in the transport, energy, and information and communications technology (ICT) sectors.

The BRI's importance for the PRC's internal development, as well as for its external diplomatic and economic relations, was highlighted during the 19th National Congress of the Communist Party of China in October 2017.[2] The PRC's strategic opening was also emphasized during the celebrations of the 70th anniversary of the People's Republic of China in October 2019, which took place amid an escalating spiral of retaliatory tariffs imposed by the US and the PRC.

Analysis of the BRI is not a straightforward task, not least because there is no clear-cut definition of which projects take place under the BRI. Nor is there a platform providing a global listing of projects, or details of progress in their implementation, financing conditions, or the involvement of local companies and labor. The data on Chinese activities presented in this report rely on the *China Global Investment Tracker* provided by the American Enterprise Institute and the Heritage Foundation. This collates investment and construction announcements from media reports, corporate statements, and government documents. However, there is no guarantee of completeness, and regular updates are necessary as firms' announcements might be revised and projects may materialize only in part or not at all.[3]

The PRC's actions – directly or indirectly linked to the BRI – extend over all continents but have a strong geographical focus on Eurasia. Within Europe, BRI-related construction works mainly target economies with a strong need for catch-up in infrastructure – those of Central, Eastern, and Southeast Europe (CESEE), which can be regarded as a gateway to Western European markets.

Until recently, the diplomatic initiative "16+1," aimed at improving cooperation between CESEE and the PRC, comprised 11 European Union member states in Central and Eastern Europe (all the countries that joined the EU in 2004 or thereafter, except Malta and Cyprus) and five Western Balkan countries (all except Kosovo); the "+1" referred to the PRC.[4]

This forum was expanded to a "17+1" format when Greece officially joined in April 2019. This step was not too surprising, in view of Chinese investments since the onset of the global economic and financial crisis. In 2009, China Ocean Shipping Company (COSCO) acquired a 35-year concession for two of the three port terminals in the Greek harbor of Piraeus. In 2016, it obtained a share of 67% of the harbor for EUR370 million and

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[1] For an introduction to the Belt and Road Initiative (comprising the Silk Road Economic Belt and the Maritime Silk Road), its main components, and corridors, see, for example, Urban (2016) or Barisitz and Radzyner (2017). BRI project maps are provided by, for example, the Mercator Institute for China Studies (merics 2018) and the Reconnecting Asia project of the Center for Strategic and International Studies (CSIS 2020).

[2] See Xi (2017) for the full speech published by the official state-owned Chinese press agency, Xinhua.

[3] The same holds true for other data sets such as the fee-based fDi Markets database (www.fdimarkets.com) or the merics Belt and Road Tracker (www.merics.org/de/bri-tracker/methodology), which is not publicly accessible.

[4] The first China-CEE summit took place one year before the BRI was officially announced in 2012 in Warsaw (Poland). Following summits: 2013 in Bucharest (Romania), 2014 in Belgrade (Serbia), 2015 in Suzhou (PRC), 2016 in Riga (Latvia), 2017 in Budapest (Hungary), 2018 in Sofia (Bulgaria), 2019 in Dubrovnik (Croatia). See: https://www.ceec-china-croatia.org/en/about-cooperation/.

announced plans to invest another EUR350 million to increase port capacity from one million to seven million containers by 2021 (Bauranov 2016).

Italy, although not part of the "17+1" forum, signed a memorandum of understanding (MoU) on cooperation with the PRC within the BRI framework in March 2019. These recent steps by individual EU member states have triggered discussions on whether an uncoordinated approach towards the BRI could lead to greater competition for Chinese investments in Europe, ultimately increasing red-tape obstacles to trade and investment. For example, the Slovenian port of Koper and the Italian port of Trieste are aiming to strengthen cooperation. However, if they follow nonaligned strategies towards the BRI, and Trieste were to experience a boom at the expense of Koper, there would be an incentive to increase trade barriers between Trieste – which is almost entirely surrounded by Slovenian territory – and EU markets. Similarly, the future attractiveness of the Italian port of Genoa depends on the Lyon-Turin rail link, but progress on its construction could be slowed in order to promote the French port of Marseille for the BRI.[5]

Austria, which holds observer status in the "17+1," signed multiple MoUs during an official visit to the PRC in April 2018. These include an MoU between the Austrian Ministry for Transport, Innovation, and Technology (BMVIT) and the PRC's National Development and Reform Commission (NDRC) regarding future cooperation within the BRI. This highlights the importance of smart city concepts, the need for a modal shift from road to rail, and the willingness of both sides to discuss the modernization of rail connections between Piraeus and Vienna along the Orient/East-Med TEN-T corridor.

The current official Orient/East-Med corridor circumvents the Western Balkans[6]. However, a relatively new EU strategy towards the Western Balkans, adopted in February 2018, together with Chinese initiatives might soon change the region's external (and internal) connectivity:

> *Implementation of the Transport Community Treaty which entered into force in 2017 will be the key step leading to progressive integration of the region into the EU transport market. Agreements on priority transport corridors between the EU and the Western Balkans as part of the trans-European transport network are already in place.*[7] *These now need to be made a reality to ensure their contribution to increasing the competitiveness of the continent as a whole.*[8]

Such moves, however, might constrain countries in the Western Balkans from independently developing their (investment) relationships with the PRC (e.g., Pavlićević 2019).

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[5] See, for example, OBOReurope: https://www.oboreurope.com/en/italy-bri-european-integration/.

[6] See European Commission (DG MOVE), Orient/East-Med Corridor: https://ec.europa.eu/transport/themes/infrastructure/orient-east-med_en.

[7] For indicative maps of the extension of the TEN-T, which were prepared with the Western Balkan region and endorsed at the Western Balkans Summit in Vienna on 27 August 2015, see Annex III Vol 30/33 and Annex III Vol 31/33 as adopted by the European Parliament and the Council in December 2013 covering the amended Commission delegated regulations (EU) 2019/254 from 9 November 2018 and (EU) 2017/849 from 7 December 2016. Available at: https://ec.europa.eu/transport/infrastructure/tentec/tentec-portal/site/en/maps.html.

[8] European Commission 2018a, 14.

2. CHINESE ACTIVITIES IN "CONNECTIVITY SECTORS" THROUGHOUT EUROPE

This section starts by showing the evolution of Chinese investments and construction volumes in Europe over time, identifying two major country groups. On the one hand, economies in the Western Balkans and the EU that are part of the "17+1" initiative are considered. Information about these economies is compared with data for countries in Europe outside the "17+1" forum, which include EU members, the economies of the European Free Trade Association (EFTA), and countries in the Eastern Neighborhood (Table 1).

Table 1: Country Grouping: Inside and Outside the "17+1"

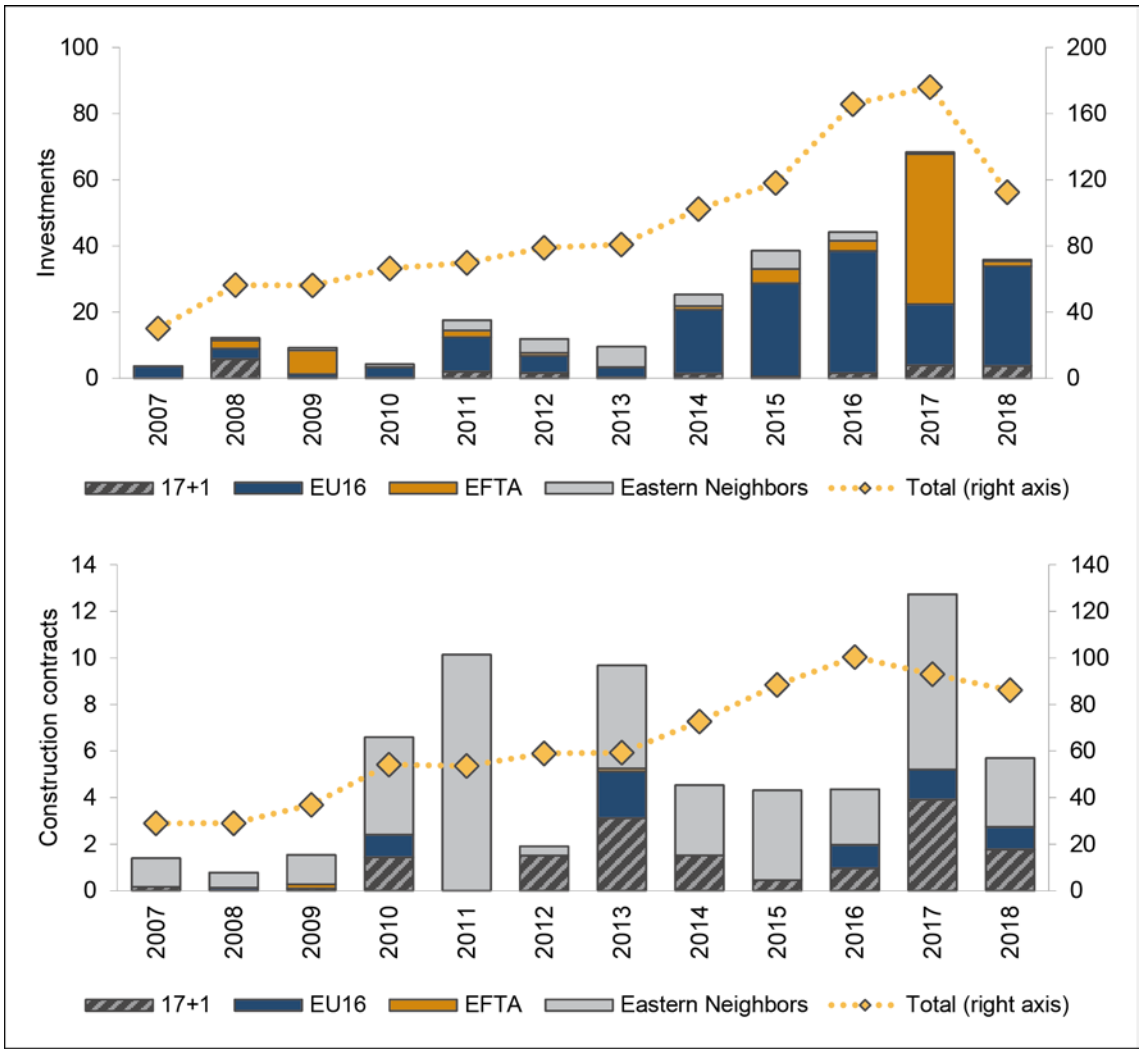
1. Western Balkans	Albania (AL), Bosnia and Herzegovina (BA), Montenegro (ME), North Macedonia (MK), Serbia (RS)	"17+1"
2. EU-CEE11	Bulgaria (BG), Czech Republic (CZ), Estonia (EE), Croatia (HR), Hungary (HU), Lithuania (LT), Latvia (LV), Poland (PL), Romania (RO), Slovenia (SI), Slovakia (SK)	
3. Greece	Greece (EL), so far the only country within the "17+1" to have joined the EU prior to 2004.	
4. EU16	Austria (AT), Belgium (BE), Cyprus (CY), Germany (DE), Denmark (DK), Spain (ES), Finland (FI), France (FR), Ireland (IE), Italy (IT), Luxembourg (LU), Malta (MT), the Netherlands (NL), Portugal (PT), Sweden (SE), the United Kingdom (UK)	Rest of Europe
5. EFTA	Iceland (IS), Norway (NO), Switzerland (CH), Liechtenstein (LI)	
6. Eastern Neighbors	Belarus (BY), Moldova (MD), Russian Federation (RU), Turkey (TR), Ukraine (UA), and Kosovo (XK), the only Western Balkan economy not part of the "17+1" forum.	

The section goes on to illustrate volumes by country since the announcement of the BRI, highlighting some projects, and continues with a sectoral breakdown. Transport, energy, and telecommunications, which are at the heart both of the BRI and of strategies recently presented by the EU to improve intra-European networks, are henceforth referred to as *connectivity sectors*.

The data suggest that the PRC's total investments had been increasing until 2017, with a drop in 2018. The share of investments in Europe in overall Chinese investments fluctuated over time, ranging from 6.5% in 2010 to 38.9% in 2017. Over the period 2007–2018, a quarter of Chinese investments targeted Europe. As shown in Figure 1, the EU16 are the prime target in Europe; the "17+1" still play only a minor role. The large investment in the EFTA region in 2017 refers to the USD43 billion takeover of Swiss seed and agrochemicals producer Syngenta by China National Chemical Corporation (ChemChina). This was described as a mistake in 2019 by the PRC's ambassador to Switzerland, Gen Wenbin, without specifying reasons.[9] His remarks may have been a response to calls by Swiss politicians for government intervention in sales of Swiss companies to foreign investors.

[9] John Miller|Reuters (29 June 2019): https://www.reuters.com/article/us-swiss-syngenta-china/chinese-envoy-says-syngenta-takeover-was-a-bad-deal-report-idUSKCN1TU0E0.

Figure 1: Chinese Investments and Construction Projects Over Time by European Region (Left Axis) and in Total (Right Axis) in Billion USD



Source: China Global Investment Tracker (Spring 2019). Note: wiiw visualization.

The lower panel of Figure 1 presents the evolution of construction projects, showing a very different geographical pattern. Eastern economies – within and outside the EU – are significantly more important. The Russian Federation accounts for a large proportion of contracts recorded for the country group of Eastern Neighbors, primarily in the energy sector. This is in line with expectations, given the PRC's incentive to improve and diversify its access to energy supplies. The Russian Federation is also central to the BRI's success in the transport sector with respect to Northern Eurasian routes. These have triggered much debate in the EU: Railways in the EU and the PRC use the so-called "standard (or normal) gauge," but countries of the former Soviet Union use broad-gauge tracks, making gauge conversion a transport barrier to tackle. Technological solutions and locations of terminals in CESEE have been discussed.[10] As long ago as 2008, the state railway corporations of Austria, Slovakia, Ukraine, and the Russian Federation founded a joint venture (Breitspur Planungsgesellschaft) aimed at extending the broad-gauge network from Košice (Eastern Slovakia) to Vienna. Public debate in

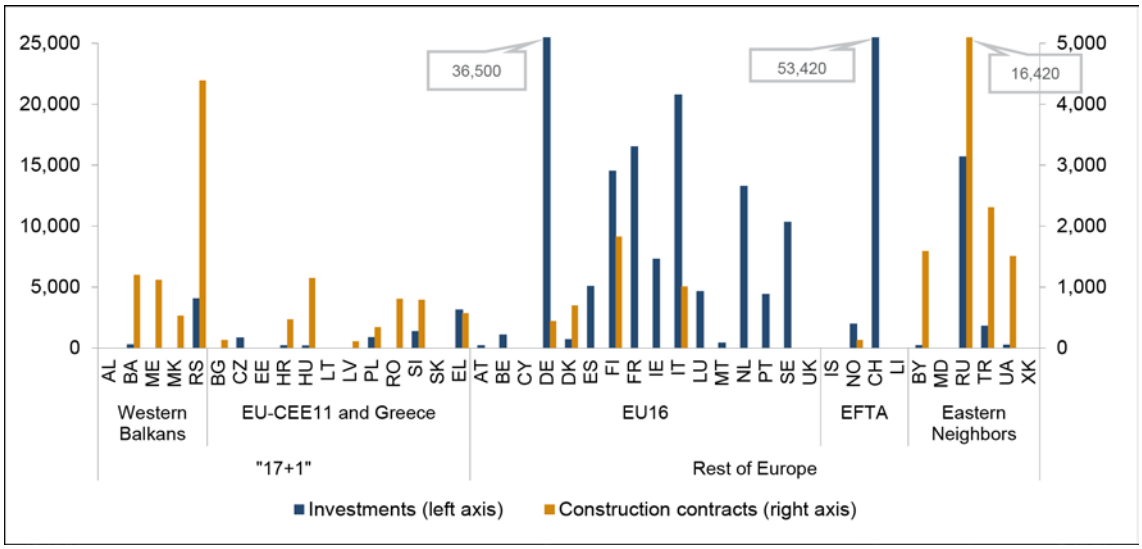
[10] For example, in the Budapest Guidelines for Cooperation between China and Central and Eastern European Countries in November 2017: http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1514534.shtml.

Austria revived in October 2019 after the publication of a report (ÖBB Infra 2019) on the environmental impact of the planned modification.

The share of Chinese construction project volumes in Europe never exceeded 19% of the total and amounted to 8.4% over the full period of 2007–2018. For most Western European economies (including Austria), no contracts are recorded at all. Europe appears to be more attractive for Chinese investments than for construction projects.

The geographic division – with Western Europe characterized by higher Chinese investment activities and Eastern Europe targeted more intensively by Chinese construction projects – is illustrated in Figure 2, focusing on volumes in million USD reported after the announcement of the BRI. The only notable exception to this trend is the Russian Federation, which is a significant destination for both investments and construction projects.

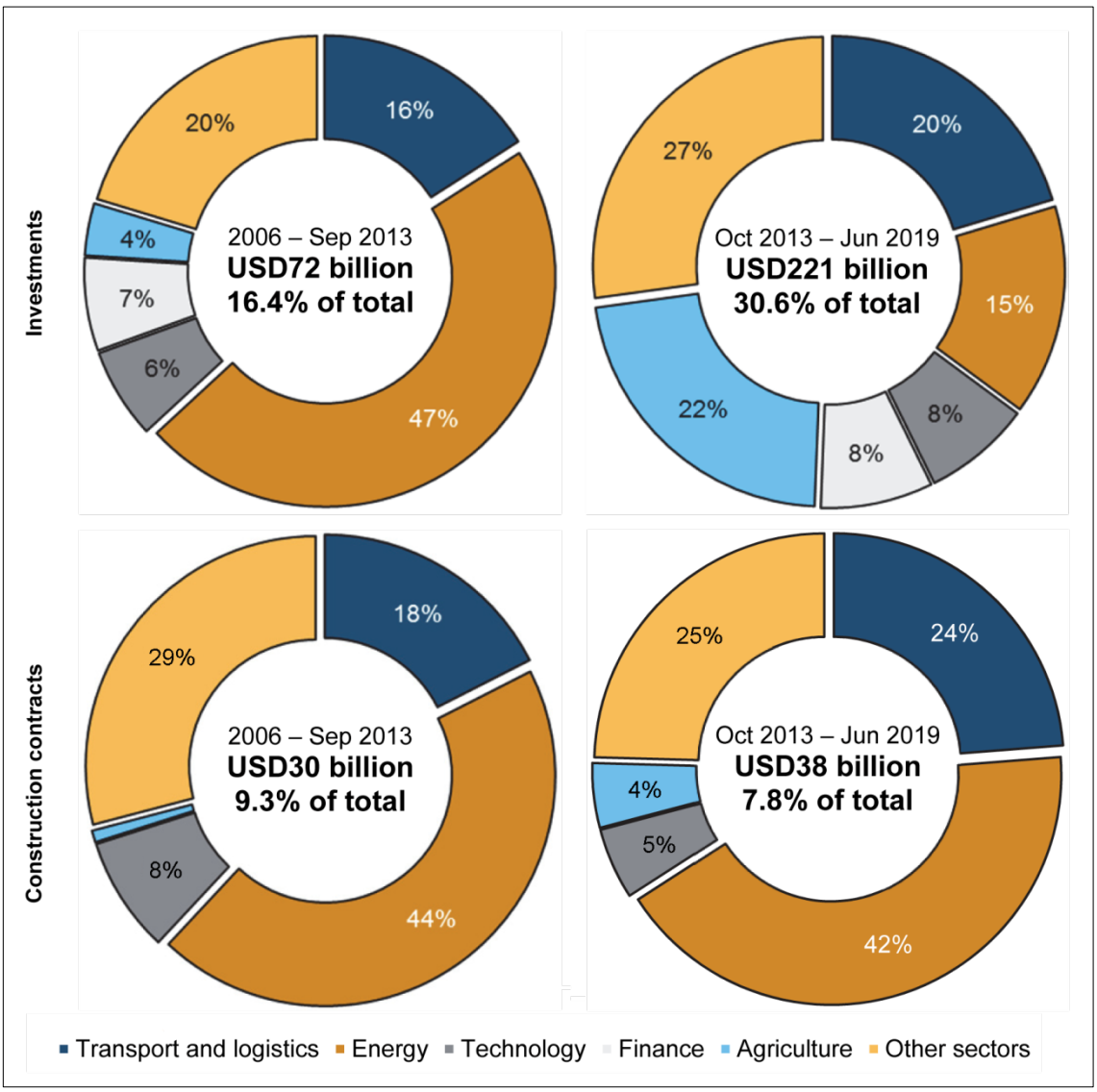
Figure 2: Chinese Activities by Country, Oct 2013 – Jun 2019, in million USD



Source: China Global Investment Tracker (Spring 2019); Author's visualization.

A sectoral breakdown shows that the *connectivity sectors* play a prominent role in investments and construction projects (Figure 3). Over time, investments diversified more than construction projects, shifting the focus away from the energy sector towards sectors such as finance, tourism, and entertainment. The 22% figure for agriculture is driven by the above-mentioned investment in Switzerland; without this single takeover, the share of the agricultural sector would be 2%. Volumes of construction contracts were increasing as well, but less dynamically than investments, with *connectivity sectors* representing 70% of the total both before and after the BRI announcement.

Figure 3: Chinese Investments and Construction Projects in Europe by Sector



Source: China Global Investment Tracker (Spring 2019); Author's visualization.

In the "17+1" region, 92% of contracts worth USD11.6 billion are attributable to *connectivity sectors* (Table 2). Only four countries in the EU outside the "17+1" framework (Germany, Denmark, Finland, and Italy) show any contracts, of which 75% are in *connectivity sectors*. In the Eastern Neighborhood, the share of *connectivity sectors* in overall construction volumes is lower, at 58%, owing to some sizeable projects in the Russian Federation's steel and chemical industries, as well as real-estate projects in the region.

Table 2: Chinese Construction Projects in Europe Oct 2013 – Jun 2019, in Million USD

Country	ISO 2	Transport and Logistics	Energy	Technology	Connectivity Sectors	Total	Connectivity as % of Total
Bosnia	BA	740	460	0	1,200	1,200	100%
Montenegro	ME	1,120	0	0	1,120	1,120	100%
North Macedonia	MK	370	0	0	370	530	70%
Serbia	RS	2,410	1,390	170	3,970	4,390	90%
Western Balkans		**4,640**	**1,850**	**170**	**6,660**	**7,240**	**92%**
Bulgaria	BG	130	0	0	130	130	100%
Croatia	HR	470	0	0	470	470	100%
Hungary	HU	1,040	110	0	1,150	1,150	100%
Latvia	LV	110	0	0	110	110	100%
Poland	PL	0	340	0	340	340	100%
Romania	RO	0	810	0	810	810	100%
Slovenia	SI	790	0	0	790	790	100%
EU-CEE11		**2,540**	**1,260**	**0**	**3,800**	**3,800**	**100%**
Greece	EL	0	230	0	230	570	40%
17+1		**7,180**	**3,340**	**170**	**10,690**	**11,610**	**92%**

Note: No contracts recorded during this period for Albania, the Czech Republic, Estonia, Lithuania, and Slovakia.

Country	ISO 2	Transport and Logistics	Energy	Technology	Connectivity Sectors	Total	Connectivity as % of Total
Germany	DE	440	0	0	440	440	100%
Denmark	DK	0	0	700	700	700	100%
Finland	FI	0	850	0	850	1,830	46%
Italy	IT	0	0	1,010	1,010	1,010	100%
EU16-"out"		**440**	**850**	**1,710**	**3,000**	**3,980**	**75%**

Note: No contracts recorded during this period for Austria, Belgium, Cyprus, France, Ireland, Luxembourg, Malta, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

Country	ISO 2	Transport and Logistics	Energy	Technology	Connectivity Sectors	Total	Connectivity as % of Total
Norway	NO	130	0	0	130	130	100%
EFTA		**130**	**0**	**0**	**130**	**130**	**100%**
Belarus	BY	300	340	0	640	1,590	40%
Moldova	MD	0	350	0	350	350	100%
Russian Federation	RU	770	7,480	0	8,250	16,420	50%
Turkey	TR	0	2,050	0	2,050	2,310	89%
Ukraine	UA	100	1,410	0	1,510	1,510	100%
Eastern Neighbors		**1,170**	**11,630**	**0**	**12,800**	**22,180**	**58%**

Note: No contracts recorded during this period for Iceland, Liechtenstein, Switzerland, and Kosovo.

Source: China Global Investment Tracker (Spring 2019). Author's calculation.

Notwithstanding the vagueness of the BRI concept, the fact that Chinese construction activities focus on sectors in which many of the targeted economies in CESEE face major deficiencies clearly increases the importance of the PRC in Europe over time. The Transition Report published by the European Bank for Reconstruction and Development (EBRD 2017) suggests that infrastructure investment needs in some Western economies of the "17+1" group (such as the Czech Republic, Slovakia, Poland, and Slovenia) were about 3%–4% of their annual GDP over the period 2018–2022. The need for infrastructure investment in the Western Balkans, Bulgaria, and the Baltic states exceeded 8% of their GDP throughout this period.[11]

The need to extend and modernize infrastructure is greatest in the transport and energy sectors. Deficiencies in the former are particularly pronounced in the Western Balkans, which are characterized by very limited North-South connections and hardly any West-East transport infrastructure, as they are currently not well integrated into the EU TEN-T network. The Baltic states, by contrast, show gaps in the energy sector. For example, the electricity network in these countries still mainly consists of 300–330 kV grids (synchronized with the Russian Federation and Belarus), while 380–400 kV transmission lines are standard elsewhere in the EU.[12] Infrastructure gaps were in general lower in the less capital-intensive ICT sector, with strong catch-up by Western Balkan economies in recent years.[13]

3. BRI EFFECTS TRICKLING THROUGH EUROPEAN VALUE CHAINS

Chinese construction projects in Europe are concentrated in Eastern Europe, and primarily in the energy sector. This does not mean, however, that economic effects are confined to these countries and sectors. The implementation of infrastructure projects triggers demand in the construction industry of that country. The domestic construction industry consequently may need inputs from other industries, stemming from domestic and foreign markets. The European Single Market is characterized by widespread production networks, such that an increase of demand in one industry in one country can result in increased production, trade, and income in many other countries and industries. The linkages between industries of different countries can be analyzed using the "wiiw Integrated Europe Input-Output Database" (Reiter and Stehrer 2018),[14] which comprises gross and value-added trade flows of 32 industries in 50 countries, covering all of Europe except Belarus, Kosovo, Liechtenstein, and Moldova for the years 2005 to 2014.

To assess the potential effect of PRC-led infrastructure projects in Europe, we use the data on construction projects retrieved from the China Global Investment Tracker for the period October 2013 to June 2019 (latest available data). We assume a "business as usual" scenario in which construction industries of recipient countries source inputs for

[11] For comparison, construction contracts reported in Table 2 in terms of countries' GDP in 2018 amounted to 7.38% of targeted Western Balkan economies, and 0.25% of Eastern EU members. For the four Western EU members outside the "17+1" for which construction contracts were recorded, these were in the size of 0.02% of their GDP in 2018; for Eastern Neighbors they were in the order of 0.48% of their GDP.

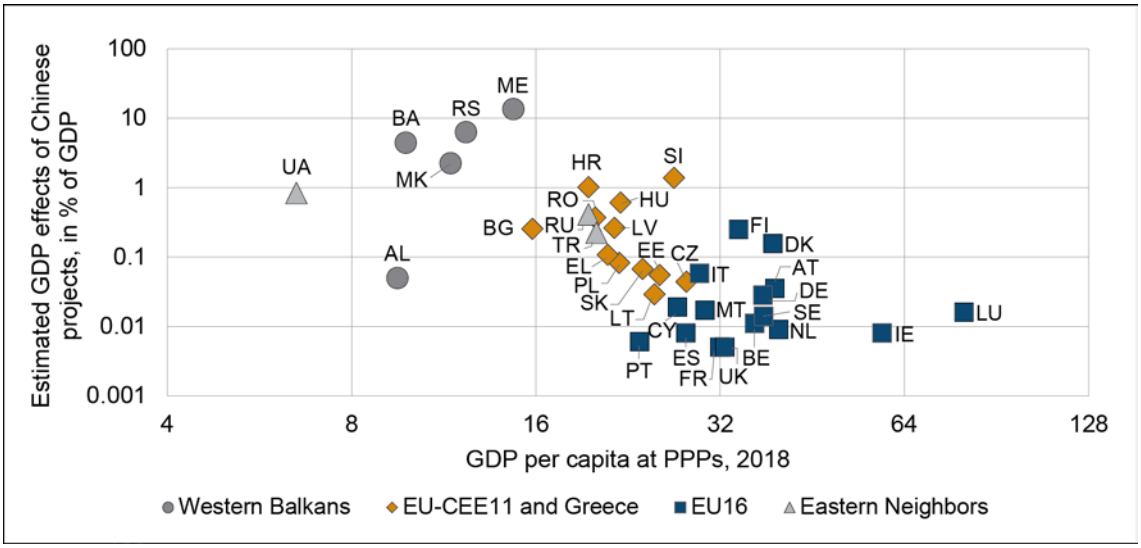
[12] See, for example, the interactive ENTSO-E Transmission System Map: https://www.entsoe.eu/data/map/ Note: In mid-2018, the Baltic states reached a political agreement on synchronizing their power system with the EU network by 2025.

[13] See, for example, the Eurostat (2019) online publication "Enlargement countries – statistical overview."

[14] The data were constructed following the methodology of the World Input-Output Database (WIOD, Timmer et al. 2016).

these projects, as was the case in the past. Put differently, our calculations do not assume that projects with Chinese involvement primarily use Chinese production networks for their implementation. The results therefore need to be interpreted as upper-bound short-term effects, as some anecdotal evidence suggests that projects initiated by the PRC involve to a large extent Chinese workers and materials.[15] However, a study by Oya and Schaefer (2019) based on fieldwork in Angola and Ethiopia, covering 76 companies (31 of which were Chinese) over the period 2016–2019, suggests that Chinese firms do not act differently to non-Chinese companies with respect to the employment of local workers, wages paid, or training provided.

Figure 4: Highest Impact in Less Wealthy Economies in Southeast Europe



Sources: GDP effects from wiiw calculations based on Chinese construction contracts in transport, logistics, energy, and technology covered by the China Global Investment Tracker between October 2013 and June 2019; in % of 2014 GDP levels; Belarus not covered by WIOD. GDP per capita at PPP: *wiiw Handbook of Statistics 2019*; Author's visualization.

Estimated GDP effects resulting from trade linkages across Europe triggered by Chinese construction projects since October 2013 are depicted in Figure 4. They need to be understood as the cumulative GDP impact over the full period of project implementation. A direct comparison with GDP per capita levels at purchasing power parities (i.e., accounting for different price levels across countries) shows that the biggest effects as a proportion of GDP occur in less wealthy countries in the Western Balkans. GDP effects exceeding 2% of GDP are found for Montenegro (13.6%), Serbia (6.3%), Bosnia and Herzegovina (4.4%), and North Macedonia (2.3%).

The highest effects among EU member states within the "17+1" group are found for Slovenia (1.4%), Croatia (1.0%), and Hungary (0.6%). For the remaining EU and EFTA members, the effect is rather small (e.g., for Austria it is calculated at 0.035%) but greater than zero, although most of them were not directly subject to any construction projects.

These figures do not include *induced effects*, which would take into account the "multiplier effect": A part of the income that is earned by households through the

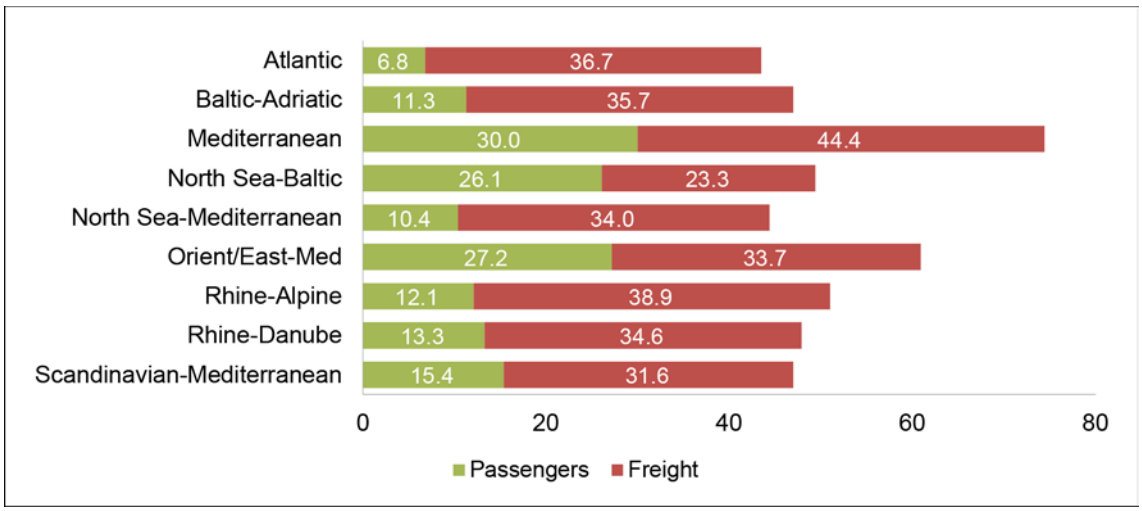
[15] E.g., Tschinderle F./*Erste Stiftung* (29 October 2018) on Serbia: "The Chinese bring money, they bring companies. Even the workers' food is imported"; Jardine B/*The Washington Post* (16 October 2019) on Central Asia; Servant J.-C./*The Guardian* (11 December 2019) on Zambia.

implementation of construction projects is going to be saved, but the other part will be spent again, further increasing the impact on GDP.

Furthermore, the analysis based on the Leontief-type demand-driven input-output model does not account for dynamic effects that are expected to occur as a medium-/long-term consequence of infrastructure development, primarily related to the *saving of cost and time*.[16] In the transport sector, the expansion and upgrading of road and rail infrastructure will ultimately result in a modal shift of goods and passenger transport. A reduction of overland transport *costs* will result in a shift from maritime to overland transport, while savings in transport *time* will result in a shift from air to overland transport.

Recent estimates by the World Bank (2019) suggest that travel times will decline by up to 12% along BRI corridors and on average by 2.5% across all country pairs in the world. For comparison, a study by Schade et al. (2018) for the European Commission suggests that the completion of the Trans-European Network for Transport (TEN-T) would bring the biggest time savings for passenger transport by rail along the Mediterranean (30%) and Orient/East-Med (27%) corridors (Figure 5). Expected reductions in freight transport time are even more pronounced (44% for the Mediterranean and 34% for the Orient/East-Med corridor).

Figure 5: Expected Savings in Travel Time by Rail in %, Resulting from TEN-T investments



Note: Transport time reductions relative to a baseline scenario that assumes no implementation of core TEN-T investments after 2016.

Source: Schade et al. (2018), 17; Author's visualization.

The modal shift will primarily concern the transport of higher-value and more time-sensitive goods. A study by Steer Davies Gleave (2018) for the European Parliament suggests that improved services attributable to the BRI could result in a modal shift of 2.5 million containers[17] from maritime transport and 0.5 million containers from air transport towards rail transport. These figures correspond to 50–60 additional trains

[16] Assuming a reduction in railway and maritime transportation costs of 50% and 5%, respectively, for economies along the BRI corridors for a simulation exercise, García-Herrero and Xu (2017) find that trade gains would occur primarily for Western European economies.

[17] Figures are reported in TEU (= twenty-foot equivalent units), which are a capacity measure in container transportation.

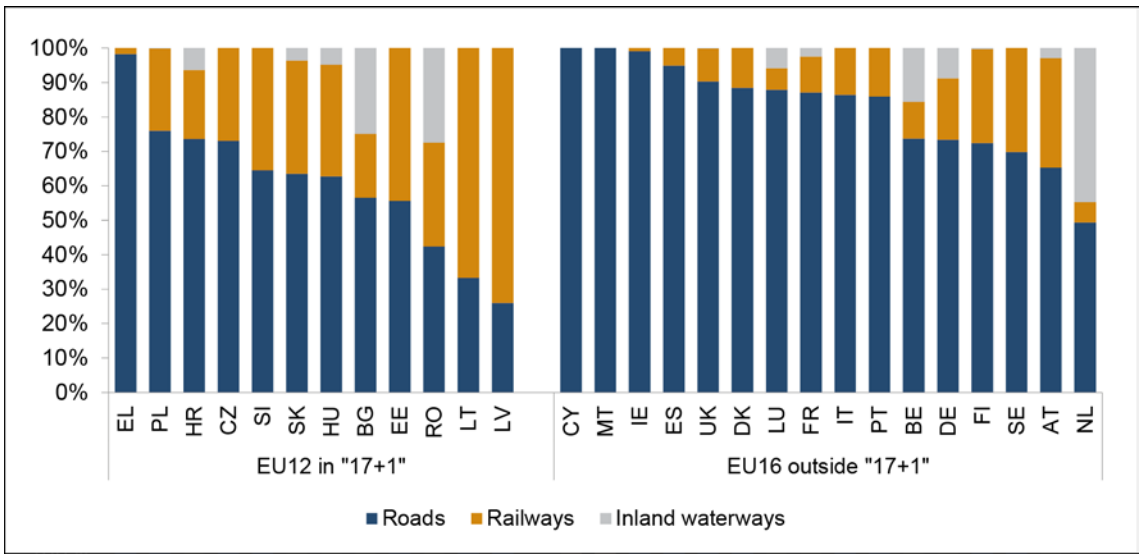
daily, or two to three trains per hour, in each direction, primarily using the New Eurasian Land Bridge through Kazakhstan, the Russian Federation, and Belarus.

Similarly to the findings by Steer Davies Gleave (2018) on the effect of BRI investments, Schade et al. (2018) find support for a modal shift towards rail transport for EU investments in the TEN-T network. For the EU28, road activity in freight transport measured in ton-kilometers is expected to decrease by 0.4%, while freight transport by rail is calculated to increase by 4.7% and via inland waterways by 0.6%. For passenger transport, road traffic in passenger-kilometers is estimated to decrease by 0.7%, while rail transport is projected to experience an even higher gain of 8.4%.

A sustainable modal shift could contribute to the European Green Deal presented by the European Commission on 11 December 2019,[18] particularly as transport is increasingly contributing to environmental degradation. The share of greenhouse gases (GHGs) attributable to the transport sector has climbed from around 20% in 1990 (when the energy industries accounted for 40%) to more than 30% in 2016, only slightly behind the 35% share of the energy industries (European Environment Agency 2018).

Better infrastructure and related services might give an additional boost to trade and investment opportunities, allowing for the diversification of traded goods and services and companies involved in international trade. Cheaper imports, better access to export markets, and increasing competition may also result in productivity gains, benefiting the economies in the long run.

Figure 6: Modal Split of Freight Transport in the EU, 2017
(%)



Notes: Percentage of each inland mode in total freight transport performance measured in ton-kilometers.
Source: Eurostat [tran_hv_frmod]; Author's visualization.

[18] See the Commission's press release: https://ec.europa.eu/commission/presscorner/detail/en/IP_19_6691.

4. UNCERTAINTIES AND RISKS ACCOMPANYING THE BRI

The development of public infrastructure on a large scale – whether initiated by the EU or the PRC – has significant economic potential for targeted economies, particularly those with large deficiencies in key infrastructure. However, there are also uncertainties and risk factors, which are not easily quantifiable but need to be considered seriously.

Foreign production networks: Ex ante, there is no guarantee that projects will be implemented by employing local contractors, suppliers, materials, or workers. If investments financed by foreign donors use production networks of the donor country for the construction of infrastructure, hoped-for GDP effects in target countries will be severely limited in the short term.

Fearing a debt trap: While EU grants do not affect public debt, loans/credits do. A study by Hurley, Morris, and Portelance (2019) concludes that eight out of 68 analyzed countries face severe risk of debt distress as a consequence of BRI infrastructure financing. Among these eight economies is Montenegro, owing to the highway project linking the port of Bar with Serbia. The first construction phase cost USD1.1 billion, equivalent to roughly a quarter of the country's GDP. The Exim Bank of China financed 85% of the first phase at an interest rate of 2%, leading the International Monetary Fund (IMF) to conclude that debt default would be likely without highly concessional funds for the second and third phases of the project.

The World Bank (2019) concludes that 12 out of 43 analyzed low- and middle-income countries along the BRI corridors might experience a deterioration of their medium-term outlook for debt sustainability, even if BRI investments boosted economic growth. No European economies feature among the countries associated with the highest risks.

Circumventing public procurement rules: State-to-state negotiations without well-established public procurement rules increase the risk that opportunities for infrastructure development are lost or undermined by corruption. For example, reports of direct payments to politicians, inflated costs through mismanagement, and direct awarding of subcontracts without tendering processes overshadowed the North Macedonian highway projects between Kičevo and Ohrid, as well as between Skopje and Štip (Makocki and Nechev 2017). The Exim Bank of China financed 85% of the projects, which were implemented by Sinohydro. Public procurement rules in the EU tend to be more stringent than in the rest of Europe. These have proved helpful in ensuring fair competition and reducing corruption, but have been contentious among EU member states.

Some leaders propagating Chinese investments as an alternative to EU investments exemplify the observable political divergence within the EU. These do not openly present to the public the difference between EU *grants* available (predominantly) for EU members, which do not have to be paid back and thus do not pose any risk to debt sustainability, and *loans* from the EU or other foreign donors, which directly affect public debt.[19] One of the most prominent examples is the Budapest-Belgrade railway project. Hungary did not adhere to EU public procurement rules, resulting in infringement proceedings in 2016. A project tender was released during the sixth China-CEE summit in 2017, but a new procurement process was launched in December

[19] For a discussion on the importance of Chinese loans in comparison to EU loans and grants see, for example, the Special Section of the *wiiw Autumn Forecast 2018* by Adarov, Gruebler, and Holzner (2018).

2018 owing to a substantial increase in expected project costs.[20] Finally, in June 2019, the project was awarded to a Hungarian-Chinese consortium.[21] Although officially resolved, criticism and concerns about future infringement proceedings persist.

Political impact of financial dependency: The PRC may well have an interest in intervening in political decisions taken in countries targeted by BRI activities. Even if it does not interfere, recipient countries might act to please important creditors. This concern was voiced loudly in the media when Greece was blocking an EU statement regarding human rights violations by the PRC shortly after COSCO acquired the majority share of the port in Piraeus in 2016. These concerns are underpinned by the increasing importance of the PRC as a creditor and investor, while the EU's budgetary position is set to weaken as a consequence of Brexit.[22]

Deterioration of standards: The PRC is working on its internal ecological transition, for example through the dismantling of coal-fired power plants, attracting green investment, and the introduction of an environmental tax. However, more stringent environmental policy may in the short-term lead to the relocation of dirty and resource-intensive industries/technologies to other countries (Baum 2017). Feng (2017) reported that Chinese companies were involved in the construction of 240 coal-fired power projects in 65 countries along BRI corridors between 2001 and 2016.

Several initiatives tackling these issues were launched during the second Belt and Road Forum in April 2019. The "Beijing Initiative for the Clean Silk Road" aims to promote transparency and combat corruption in line with the UN Convention Against Corruption. The "Green Investment Principles for the Belt and Road" are aimed at improving environmental and social sustainability in accordance with the UN 2030 Agenda for Sustainable Development and the Paris Agreement. Finally, the Debt Sustainability Framework launched by the PRC's Ministry of Finance should avoid BRI-induced debt traps. How these initiatives are going to be operationalized remains to be seen.

4.1 European Policy Needs: Create a Level Playing Field and Increase Complementarity

Without doubt, the BRI brings opportunities as well as challenges for Europe. The EU and countries targeted by the BRI should become more proactive in order to maximize the benefits of the initiative and reduce the risks associated with it.

An important step towards a level playing field in infrastructure development and investments would be a successful conclusion of ongoing negotiations of the stand-alone *EU-China Investment Agreement*. Negotiations started in 2013, the same year that the BRI was announced. At the EU-China summit on 9 April 2019, the parties agreed to accelerate negotiations and work towards the conclusion of the agreement by 2020. Starting in June 2019, negotiation rounds have been taking place almost every month (eight rounds between June 2019 and April 2020).

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[20] According to Ralev (2018), the Hungarian government announced that the PRC had offered a loan over a period of 18 months with an interest rate of 2.5% for the 152 km Hungarian section.

[21] Joo, F. *International Railway Journal* (2019): "Ownership of the CRE Consortium is split 50:50 between Chinese-owned and Hungarian companies. China Tiejiuju Engineering and Construction Hungary and China Railway Electrification Engineering Group (Hungary) will work with RM International, founded by R-Kord and Mészáros és Mészáros."

[22] Following a referendum in June 2016, the United Kingdom withdrew from the European Union on 31 January 2020. This event is known as "Brexit" ("British exit"). During a transition period set to the end of the year, the UK and the EU are supposed to negotiate their future relationship.

According to the European Commission, discussions have advanced in the fields of financial services, capital movements, and commitments towards national treatment (i.e., nondiscrimination), and substantial progress has been made in state-to-state dispute settlement. Negotiations also cover topics such as transparency, procedural fairness during competition procedures, and sustainable development. Since January 2020, discussions have focused on revised offers (exchanged in December 2019), particularly related to investment liberalization and state-owned enterprises. The agreement would provide the foundation for a rule-based bilateral relationship predicated on the principle of nondiscrimination and reciprocity, enforceable by a common dispute settlement mechanism. It could improve transparency and predictability and thus increase the trust of Chinese and EU investors.

Furthermore, the EU maintains – and continues to expand – its sizeable *network of trade agreements*. The PRC, however, is not on the agenda. Since the PRC's accession to the WTO in 2001, the multilateral trade rules of the WTO have formed the basis for EU-PRC trade relations and dispute settlement. A very shallow bilateral Trade and Economic Cooperation Agreement dating back to 1985 does not reflect the current reality of EU-PRC trade. Nonetheless, negotiations on a necessary upgrade of the bilateral trade agreement, which started in 2007, were halted in 2011. Given the publicly raised concerns regarding expected import surges resulting from BRI infrastructure investments, a revival of negotiations to achieve a new-generation trade agreement extending from tariff reductions to product, labor, and environmental standards could promote trust among European consumers. Finding common ground on trade matters is particularly urgent, given that the US administration is undermining multilateralism. The US has blocked the appointment of new members to the Appellate Body of the WTO, which became nonfunctional in December 2019.[23]

Trade and investment are closely linked, particularly in the connectivity sectors targeted by the BRI. All of these sectors can be regarded as strategically important and are therefore subject to the new *EU foreign investment screening regulation* that entered into force in April 2019.[24] Within the EU, 14 member states have a national screening mechanism in place, including Austria, Germany, and Italy. Although nondiscrimination is a key requirement, the PRC could become the main economy subject to investment screening, due to its increasing importance in inward investment in the EU and also because state-owned enterprises – which play a prominent role in Chinese activities – are associated with a higher risk in terms of collective security.

Apart from creating a level playing field, better *coordination of infrastructure development* in the energy, transport, and ICT sectors between recipient countries, the EU, and the PRC would be beneficial for the region. Improved complementarity should be pursued within the three new EU initiatives presented last year, as set out below.

[23] By 10 December 2019, the terms of two judges had expired. These agreed to continue their work on three appeals for which oral hearings had been completed. After that, there was only one judge left (out of seven, originally) and the WTO Appellate Body became dysfunctional.

[24] See Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019: https://eur-lex.europa.eu/eli/reg/2019/452/oj.

4.2 Invest EU Program

This program was proposed in June 2018 as part of the long-term EU budget for the period 2021–2027. It is intended to succeed the European Fund for Strategic Investments (EFSI), which is at the heart of the Investment Plan for Europe, the so-called *Juncker Plan*. It aims to trigger EUR500 billion in investments in the EU through the provision of EUR33.5 billion in guarantees for business and infrastructure projects (EUR26 billion from the EU budget and EUR7.5 billion from the EIB Group).

Figures on the achievements of the ongoing program are regularly updated. As of March 2020, EUR60.9 billion of financing by the EIB and EUR24.5 billion of financing by the European Investment Fund (EIF) had been approved, with a total investment of EUR466 billion related to these EFSI approvals. Of these investments, 31% target smaller companies and 26% are dedicated to research, development, and innovation (RDI). Among the *connectivity sectors*, energy has the highest share (17%), followed by the digital (9%) and transport (7%) sectors.

Major beneficiary countries of the EFSI with respect to approved financing and expected investments in absolute terms include France, Italy, Spain, Germany, and Poland. However, in terms of triggered investment relative to GDP, Greece ranks first, followed by Estonia, Portugal, Bulgaria, and – again – Poland (European Commission, EIB, and EIF 2020).

The program envisages guarantees in the order of EUR47.5 billion (EUR38 billion from the EU budget and the rest from financial partners such as the EIB), aimed at generating total investment in the EU of EUR650 billion over a seven-year period through crowding in of private and public investment. The main value added of the new program is the aggregation of currently multiple EU loan and guarantee financing instruments as well as 13 different advisory services (European Commission 2018b). However, this instrument does not include economies outside the EU.

4.3 Six EU Flagship Initiatives for the Western Balkans

The EU initiatives towards the Western Balkans are based on the previously mentioned strategy for "A credible enlargement perspective for and enhanced EU engagement with the Western Balkans"' adopted in February 2018 (European Commission 2018a), which suffered a setback in October 2019 when the European Council postponed the start of EU enlargement negotiations with Albania and North Macedonia. [25] Increasing connectivity within the region as well as between the Western Balkans and the EU features among the targets (European Commission 2018c). The action plan is presented in the annex to the strategy document.

In the transport sector, the EU aims to increase the use of the Connecting Europe Facility (CEF) in the Western Balkans, which implies that the region will gain better access to EU grants. Currently, loans dominate EU financing in the Western Balkans and therefore also increase the region's indebtedness. Furthermore, the region should be better integrated into the Trans-European Network for Transport (TEN-T), particularly through the inclusion of the region in the new rail strategy for the Orient/East-Med and the Mediterranean core TEN-T corridors, and through the removal of barriers at road and rail border crossings.

[25] See, for example, wiiw News, "Making the best of a bad hand" (29 October 2019): https://wiiw.ac.at/n-399.html.

The expansion of the Energy Union to the Western Balkans is part of the action plan for the energy sector. In the ICT sector, the EU provides support in developing eGovernment, eHealth, digital skills, and broadband infrastructure. In view of potential future EU enlargement, it will enhance support for the implementation of EU regulations in line with the EU Digital Single Market.

4.4 EU Strategy for Connecting Europe and Asia

Transport, energy, and digitalization form three of the four pillars of the EU strategy for Connecting Europe and Asia presented in September 2018. The fourth facet of connectivity addresses the human dimension, including the areas of education, research, innovation, culture, and tourism.

Fostering cooperation within the EU-China Connectivity Platform set up in 2015 is a key action addressed in Chapter 4 on building international partnerships for sustainable connectivity, to "promote the digital economy, efficient transport connectivity, and smart, sustainable, safe, and secure mobility, based on the extension of the TEN-T network, and promote a level playing field in investment" (EEAS 2018, 9). This cooperation forum explicitly addresses actions to identify synergies between the European TEN-T policies and the Chinese BRI. The fourth chairs' meeting took place in the course of the 21st EU-China summit in April 2019, where parties agreed, *inter alia*, on the terms of reference for a joint study on sustainable railway-based transport corridors between Europe and the PRC via the Balkan Peninsula.

In addition, five expert group meetings[26] took place between 2016 and 2019, at which both parties presented planned transport infrastructure projects potentially suitable for cooperation. A total of 20 projects in the PRC, 20 projects in the EU, five projects in other European countries, and four projects in Central Asian economies have been collected.[27] Within the EU, 18 projects addressed the EU-CEE economies; the remaining two concerned the Italian ports of Genoa and Trieste.

The EU might go a step further, initiating a cohesive *complementary European Silk Road*. Holzner, Heimberger, and Kochnev (2018) propose two main overland transport connections throughout Eurasia, with substantial employment and growth potentials. Construction costs for state-of-the-art transport infrastructure along the northern route, from Lisbon to Uralsk (on the Russian-Kazakh border), together with the southern route, from Milan to Volgograd (Russian Federation) and Baku (Azerbaijan), are estimated at around EUR1 trillion, or 7% of EU GDP. Currently, investment in infrastructure is particularly attractive, for three reasons: the underdevelopment of infrastructure in peripheral regions in Eurasia; low/negative real interest rates; and potential growth effects that allow for "self-financed" investment. Holzner (2019) proposes a European Silk Road Trust (ESRT) similar to the model of the Austrian publicly owned ASFiNAG corporation in charge of the planning, financing, maintenance, and tolls collection for Austrian highways, but extending to multimodal transport infrastructure with an emphasis on more sustainable modes of transport. Initially owned by euro area and EU member states as well as by other participating countries, a European Sovereign Wealth Fund (ESWF) could replace euro area member states as the main guarantors for ESRT bonds in the medium to long term.

[26] EU-China Connectivity Platform expert group meetings: November 2016 in Beijing, May 2017 in Brussels, July 2018 in Beijing, November 2018 in Brussels, and July 2019 in Beijing. See EU-China Connectivity Platform (2019) for a list of presented projects between 2016 and 2019.

[27] See Appendix 1 for lists of projects. Unfortunately, these are not accompanied by information on expected project volumes, whether and how parties in fact cooperated, or how they were supposed to be financed.

It is in the interests of the EU and the PRC, but even more so of the economies in Eurasia targeted by infrastructure financing and investments, to make European and Chinese initiatives a success for economic and political reasons. However, without sufficient information, citizens will not be able to embrace these large-scale undertakings. Reducing the complexity of financing structures,[28] for example, as envisaged for the InvestEU Program, is a step in the right direction on a rather long journey towards *transparency*, which should also cover the collection of official data and *monitoring* of the financing and implementation of projects and their effects. The communication of the reduction of transport time and costs, the impact on local employment, and the effects on economic growth, regional wealth distribution, and public debt might influence public perceptions as well as the actions taken by investors and donors.

5. EPILOG

The global unfolding of the COVID-19 crisis in 2020 will result in sharp breaks in investment trends, postponement, or even cancellation of construction plans. The future progress of the BRI will depend on the actual scale of the economic downturn of donor/investor and recipient/target economies for infrastructure development. In Europe, the economic environment for Chinese investment activities will alter, for example due to new guidance to EU member states on investment screening, and the Coronavirus Response Investment Initiatives of the European Commission. However, policy recommendations discussed in this paper continue to hold for the time, after the major health and economic risks related to COVID-19 will have been resolved.

[28] European grants and loans for the development of connectivity sectors encompass, for example, the Connecting Europe Facility (CEF), the European Fund for Strategic Investments (EFSI), and the European Structural and Investment Funds (ESIF), including the Cohesion Fund (CF), which partly acts through the CEF. The Western Balkans receive funding, *inter alia*, through the Instrument for Pre-accession Assistance (IPA) as well as the Western Balkans Investment Framework (WBIF). See Gruebler et al. (2018) for a more detailed discussion of Chinese and EU financing institutions and instruments.

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Data

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APPENDIX

EU-China Connectivity Platform Projects in Europe (2016–2019)

	Projects in Europe within the EU	Location
1.	Hemus motorway project and Black Sea motorway project	Bulgaria
2.	Restoration of the design parameters of the Ruse-Varna railway line	Bulgaria
3.	Modernization of the Sofia-Pernik-Radomir railway line project	Bulgaria
4.	Modernization of the Karnobat-Sindel railway line	Bulgaria
5	Rijeka-Zagreb-Budapest railway	Croatia
6.	Accessibility of Rijeka port in the context of the Croatian railway network: • Karlovac-Oštarije section • Oštarije-Škrljevo section • Škrljevo-Rijeka-Jurdani section	Croatia
7.	V0 rail cargo line bypassing Budapest	Hungary
8.	Hungary-Serbia railway	Hungary
9.	Genoa Port breakwater project	Italy
10.	Trieste integrated rail hub	Italy
11.	North Sea Baltic Corridor, comprising the following subprojects: • Logistics and industrial center project at the freeport of Riga • New terminal “Northern port” project at the freeport of Ventspils • Rail Baltica intermodal logistics center freight village • Logistics center for e-commerce business at Riga International Airport	Latvia
12.	Adjusting Odra River waterway (E30) to international waterway standards	Poland
13.	Construction of Silesian channel (Silesia waterway project)	Poland
14.	Construction of middle and lower Vistula cascade (waterways E40 and E70)	Poland
15.	Warszawa-Brzesc connection – extending E-4o waterway	Poland
16.	Connections Timisoara – Romanian/Serbian border: • Timisoara-Moravita motorway • Timisoara-Stamora Moravita railway line	Romania
17.	Development of the Košice intermodal terminal (Košice joint transport terminal construction project)	Slovakia
18.	Development of the Leopoldov intermodal terminal	Slovakia
19.	Development of the Bratislava trimodal terminal	Slovakia
20.	Railroad project from Koper to Divaca	Slovenia
	Projects in Europe outside the EU	**Location**
1.	Adriatic Ionian motorway	Albania
2.	Corridor 5c highway project	Bosnia and Herzegovina
3.	Mateševo-Andrijevica section of the Bar-Boljare highway (BBH)	Montenegro
4.	Serbia railway network	Serbia
5.	Ferry railway complex in Chornomorsk port	Ukraine

Source: EU-China Connectivity Platform via European Commission: https://ec.europa.eu/transport/sites/transport/files/eu-china-connectivity-platform-projects-2019.pdf.