

### China's Inroads into Central, Eastern, and South Eastern Europe: Implications for Germany and the EU

Pepe, Jacopo Maria

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## China's Inroads into Central, Eastern, and South Eastern Europe **Implications for Germany and the EU**

*Jacopo Maria Pepe*

China's increased engagement in Central, Eastern, and South Eastern Europe has aroused concerns in Europe that China is pursuing a divisive strategy. Its primary goal, however, is to use the region as a gateway to Western Europe's markets while including the EU in its own Eurasian integration project; in Beijing's view, a robust regulatory EU is doubtless preferable to a fragmented Europe. China's deepening involvement in the region could nevertheless increase economic divisions within the EU as whole. As a trade triangle emerges involving China, Germany, and the Visegrad states, the "German-Central European manufacturing core" potentially stands to gain at the expense of the EU's Atlantic and southern European member states. Germany must address this risk with a triple strategy that balances national interest, EU cohesion, and engagement with China. This involves, first, working with the Visegrad Four, with other European countries, and with EU institutions to forge a deeper and more effective cooperation with China to enhance transport connectivity and economic modernization, particularly in the Western and Eastern Balkans. Second, Germany should increase pressure on China to open up the Chinese domestic market to ensure mutual access. And third, it should promote forward-looking European industrial policy centered on the digitalization of value and supply chains for Central, Eastern, and South Eastern Europe. This would allow Germany to prevent intra-European divisions from deepening, while taking advantage of its triangular relations with China and the countries of Central Europe and fostering mutually advantageous integration across Eurasia.

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# China's Inroads into Central, Eastern and South Eastern Europe

## Regional and Global Implications for Germany and the EU

*Jacopo Maria Pepe*

### Introduction

In November 2016, China's Prime Minister Li Keqiang attended the Fifth China-Central Eastern Europe Summit. In his remarks, he proposed the intensification of "pragmatic cooperation" between China and the countries of Central Europe, Eastern Europe, and South Eastern Europe (here CEE) to expand two-way trade, transport connectivity, industrialization, and financial cooperation. His speech reaffirmed both China's interest in the region and its support for the European integration process.<sup>1</sup>

To many European observers, however, China's engagement in CEE remains ambiguous, and to some, it already seemed outright suspicious by the time the cooperation had gathered steam in 2012. Indeed, since then, China's trade and investment activities in CEE have raised questions about China's goals and strategy toward the EU at large. For instance, shortly after the launch of the forum's secretariat in 2012, the EU expressed its skepticism about a move that was largely seen as an attempt to further "bilateralize" relations with the EU. As the EU's then high representative for foreign policy Catherine Ashton put it at the time, the CEE initiative carried the risk that China-EU relations could take place on two levels: at the EU level and at the bilateral level.<sup>2</sup> Today, increasingly tense relations between China and individual EU member states – particularly Germany – over China's acquisitions of high-technology assets have given new momentum to the idea that China is pursuing a "divide and conquer" strategy, one that, by engaging individual countries bilaterally, aims to acquire national technological and industrial assets while bypassing EU regulations.<sup>3</sup> According to this logic, the CEE-China cooperation framework could well be considered part of this divisive strategy.

In fact, rather than aiming to divide the EU, China's strategy in CEE has from the beginning been to pursue greater engagement with the EU as a whole using CEE as a cooperation platform.<sup>4</sup> This was stressed in the Riga Declaration that concluded the Fifth China-CEE Summit

in November 2016: "All participating EU member states reaffirm that the implementation of the actions envisaged by this document must be done without prejudice to the competencies of the European Union and with respect for the obligations stemming from their membership of the European Union."<sup>5</sup>

Five years after the launch of the "16+1" Initiative, China has indeed become increasingly aware that the region is too complex and inhomogeneous – and China's experience with it not yet extensive enough – to exclude the EU, even if relations with the EU may become more complicated. This said, risks of a "division" of Europe – both across the member states and between CEE and the rest of the EU – should be taken into greater consideration today. It is possible that the EU may further prove unable to approach China in this region with a comprehensive strategy of its own that takes into consideration structural changes both inside the EU and in Eurasia at large. In fact, the impact on the EU of the 16+1 initiative (and of its Eurasian corollary, the One Belt One Road Initiative, or OBOR) – and the implications for Germany – will depend greatly on the counterstrategy that Germany and the EU develop in response, and particularly on the degree to which they can coordinate their efforts with the CEE countries themselves.

### China and Central Eastern Europe: Trade, Transport, and China's Grand Strategy

China established the new cooperation mechanism with Central, Eastern, and South Eastern Europe known as the "16+1 Cooperation Framework" in 2012. The forum – consisting of China plus 16 Central Eastern and South Eastern European countries, both EU members and non-members – has developed relatively rapidly into a loosely institutionalized form, with secretariat, national coordinators, and regular meetings.<sup>6</sup> The forum has met on a yearly basis since its launch, while bilateral meetings

with single members of the forum have been taking place between the general meetings to facilitate political and economic coordination at the multilateral level.<sup>7</sup> Against this backdrop, China has launched a number of multilateral initiatives to strengthen cooperation in three areas: trade, investment, and transport links.<sup>8</sup> For their part, many CEE countries have expressed interest in deepening relations with China by deepening economic and commercial bilateral ties to improve connectivity in the region and eventually gain more strategic leverage vis-à-vis both the EU and Russia.<sup>9</sup>

### Trade and investment

While the “16+1” format’s original target of increasing total bilateral trade to ninety billion euros by 2015 has not been met, trade between the 16 CEE countries and China is indeed booming. It reached more than forty billion euros that year. It is nonetheless still unclear whether this boom has been due to the 16+1 framework or has deeper roots. Indeed, the launch of the 16+1 forum seems to have had a fairly low impact on the level of Chinese engagement in CEE, as trade was already on the rise before the initiative was launched. As figure 1 shows, the sharpest increase occurred between 2006 and 2010, when China’s total trade with CEE jumped from 18 billion euros in 2006 to more than 33 billion in 2010.

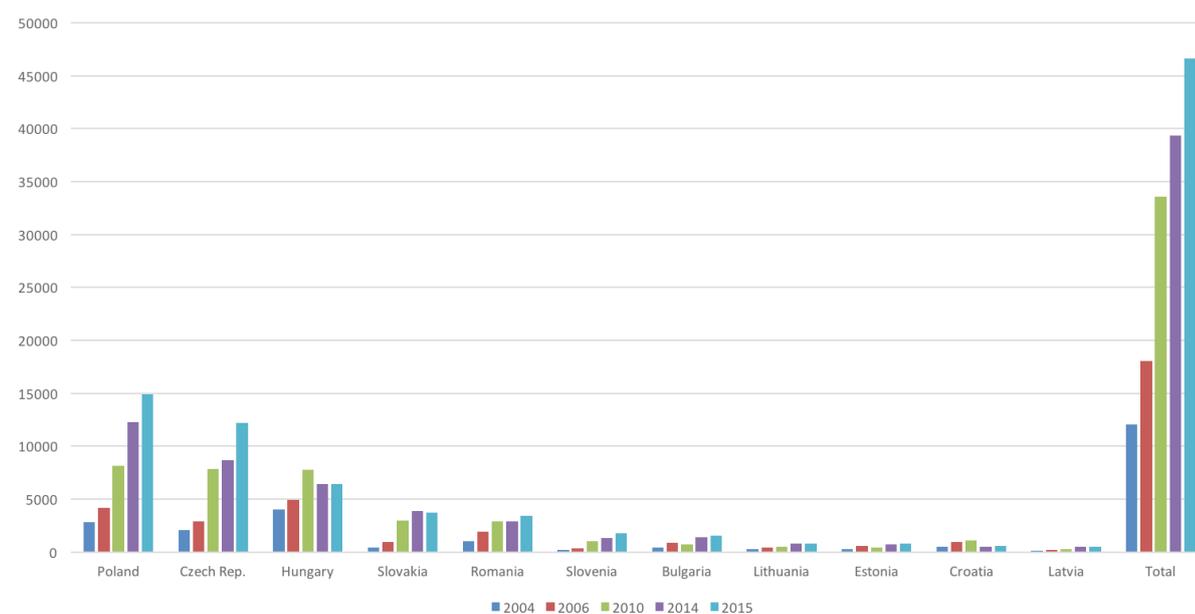
In terms of investments, by 2015 the level of Chinese foreign direct investment (FDI) in the 16 countries was still very low compared to Chinese FDI in the EU as a

whole. (See figure 2.) Cumulative Chinese FDI (from 2000 to 2015) in the eleven CEE countries that are now EU member states had reached slightly more than 3.7 billion euros by 2015. In comparison, Chinese FDI in the EU as a whole reached almost 65 billion euros in the same period and was mainly concentrated in the four big advanced economies of the United Kingdom, France, Italy, and Germany. The level of China’s FDI in CEE has, however, increased rapidly since EU enlargement. It accelerated during the crisis year 2008, particularly with greenfield investments in energy, transportation, and manufacturing. China’s main goal is to gain access to local markets while using CEE EU members as the gateway to Western European economies. Cheap and skilled labor forces there and less regulation make these markets attractive for Chinese companies. Investment and trade with non-EU members in the Western Balkans have followed a similar path. While still relatively low, China’s exports to Albania, Bosnia-Herzegovina, Montenegro, Serbia, and Macedonia more than doubled between 2004 and 2014, while imports from these countries increased sevenfold in the same time frame.<sup>10</sup>

### Transport cooperation

The greatest potential for the 16+1 mechanism is likely in the transportation sector. Since the establishment of the 16+1 in 2012, transportation and logistics have become the main areas of cooperation, and both China and CEE are interested in strengthening regional connectivity.<sup>11</sup>

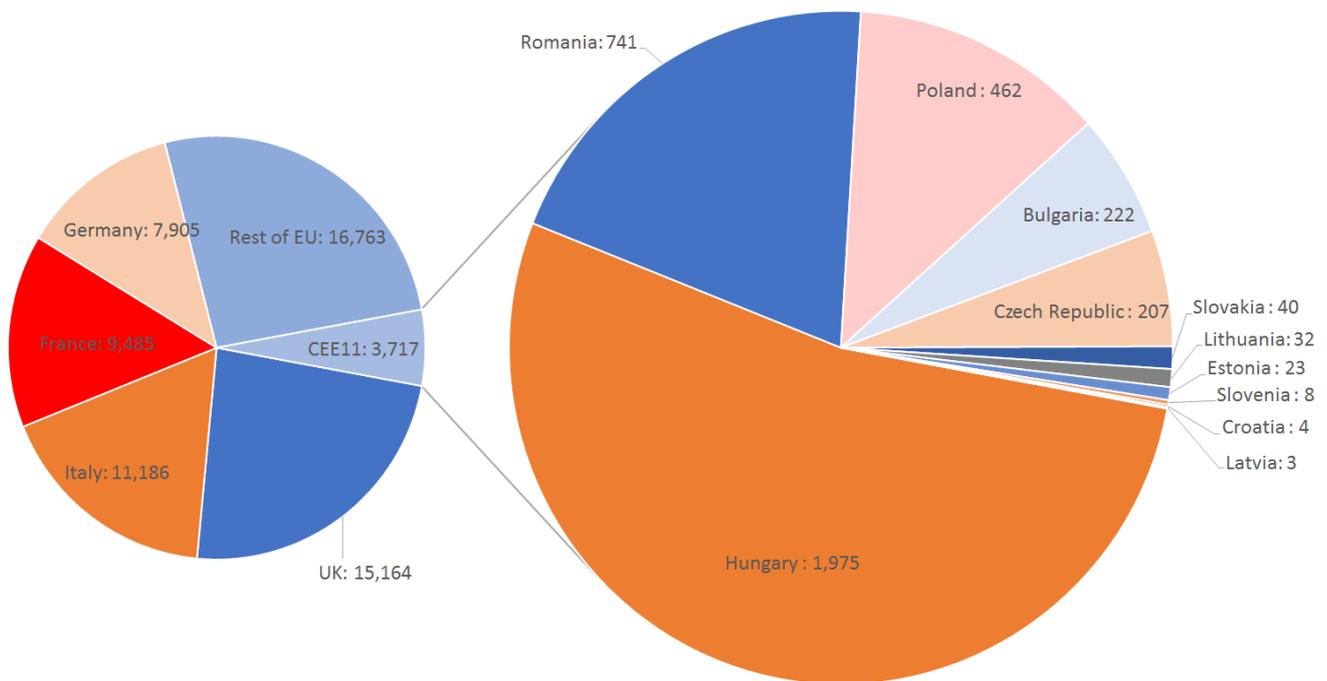
**Figure 1: Trade between China and the EU’s eleven CEE member states, 2004–15, in million euros**



Source: Author's own calculations, based on Eurostat data 2004–15

**Figure 2: Chinese FDI (2000–15) in select EU member states and CEE countries, in million euros**

Detail: Chinese FDI (2000–15) in the eleven CEE states now in the EU

Source: Author's own calculations, based on Hanemann and Huotari<sup>12</sup>

China considers Poland and Hungary as transshipment hubs for overland routes from Russia and Central Asia and as part of intermodal corridors from Central Asia (via the Black Sea) and the Suez Canal (via the Balkans).<sup>13</sup> While the overland Eurasian corridors are already attracting traffic and the main focus is on streamlining logistic services, China's investments have decisively prioritized the Western and Eastern Balkans and target Hungary as the logistic and transportation hub for CEE.<sup>14</sup>

In 2016 China's biggest shipping company, COSCO, finalized the acquisition of the controlling stake of the Greek port of Piraeus. Piraeus has become China's first port of call in the Mediterranean for westbound traffic via the Suez Canal. As a consequence China has reoriented its focus to the hinterland and port infrastructure of the eastern Mediterranean and the Balkans. Ports like Thessaloniki (Greece), Trieste (Italy), Koper (Slovenia), and Constanta (Romania) have become attractive for China, both as transshipping hubs and intermodal gateways to southern Germany and central Europe.<sup>15</sup> From some of these ports, three EU-backed, pan-European freight corridors along the eastern and Western Balkans connect with CEE across the Danube plain, converging in Budapest: No. 7 (Orient/East Mediterranean), No. 9 (Rhein-Danube), and No. 6 (Mediterranean). Hungary's capital is hence set

to become the main point of entry from the southeastern Mediterranean to Central Europe. This said, bottlenecks and some missing links still reduce the corridors' impact in intra-European container traffic, and two of them (Nos. 7 and 9) will not be finalized and operative before 2018. China's investments in the high-speed railway connection between Serbia and Hungary (the so called Europe-China Land-Sea Express Line) and in the modernization of the rail, road, and port infrastructure in the Balkans and in South Eastern Europe (specifically Serbia, Hungary, and Romania) aim to complement the European projects, free up volumes for freight traffic, and speed up operability of the corridors.<sup>16</sup>

For CEE, China's investments in the transportation sector could accelerate the realization of the long planned Baltic-Adriatic-Black Sea Corridor as envisioned in the "Riga Guidelines" approved at the Fifth China-Central Eastern Europe Summit in November 2016. To this end, a new China-CEE fund with a volume of ten billion euros has been set up to finance transport infrastructure projects along the corridor.<sup>17</sup> For China, there is apparently significant incentive to create integrated logistics services operated by Chinese companies and become able to offer competitive freight rates for intermodal container traffic along multiple routes from Suez, Turkey, and Central

Asia/the Caucasus to Central Europe, southern Germany, and the Baltics – part of a bid to reduce the dependence on such north European ports as Hamburg, Rotterdam, and Antwerp.<sup>18</sup>

Hence, the vast region targeted by China in the 16+1 framework is a geographical “platform” where Chinese engagement could complement European financial instruments for the development of eastern and southeastern parts of the EU. The harmonization of regional projects both with continental corridors sponsored by China and with European initiatives like the TEN-T Corridors has therefore become the core of the recently announced China-EU Connectivity Platform.<sup>19</sup>

### China's grand strategy: Transform CEE into the EU's gateway to Eurasia

All in all, the 16+1 initiative was probably not in itself decisive in accelerating bilateral ties between China and CEE countries, as trade and investment already started increasing before it was launched. It is nonetheless undeniable that China's engagement with this region has accelerated dramatically in the past decade. China's presence is now well established and offers mutual benefits in terms of investment, particularly in the transportation and energy sector and in commercial opportunities. However, the volume of both trade and investments is still fairly low.

There is so far little evidence of a strategic attempt on China's part to “divide” CEE from the rest of the EU – even though some ambiguity remains as to the level of the EU's involvement in the 16+1 framework. Rather, China's willingness to create synergies between investment initiatives part of the 16+1 framework (like the China-CEE Fond) and bilateral cooperation mechanisms with the EU

(like the “Juncker investments plan” for less developed regions of Europe) goes in a decisively more cooperative direction. For instance, shortly after the Juncker Plan was announced, China expressed interest in actively participating in it; in 2016 Beijing and the EU concluded a technical agreement allowing Beijing to contribute to the plan with up to ten billion euros from China's New Silk Road Investment Fund.<sup>20</sup> While still formally separated from the 16+1 initiative, the strong focus on infrastructure development of both the Juncker Plan and China's One Belt One Road initiative (OBOR, a plan for connecting China to Eurasia) make these and other initiatives like the aforementioned Connectivity Platform naturally complementary to projects in transportation and industrial sectors that are part of the 16+1 framework, as underlined by Chinese diplomatic officials.<sup>21</sup>

Ironically, however, increased synergies between EU initiatives, the 16+1 framework, and China's OBOR initiative augment the evolving strategic role China attaches to the region, notwithstanding the country's still moderate degree of involvement.

Underestimating the strategic dimension of the 16+1 initiative would be a mistake, particularly after the launch of OBOR in 2013. Before the 16+1 framework was launched, China lacked an overarching geo-strategic orientation for framing its deepening engagement with the CEE region, and the latter ranked low in China's foreign economic policy priorities. With the 16+1 initiative, China came to consider its CEE engagement both as part of the country's “Go Out strategy” (by which it encouraged Chinese companies to become more active abroad, particularly on the European market) and, most prominently, as an instrument to engage the EU while strengthening the partnership in a difficult economic period for many EU

**Table 1: Germany-V4 trade compared to cumulated trade with the UK, Italy, and France, 2015, in billion US dollars**

Germany's export, import, and trade turnover with Visegrad countries, bilateral and cumulated			
	Export	Import	Export + Import
Poland	42,886	52,261	95,147
Czech Republic	36,564	50,567	87,131
Hungary	23,589	27,344	50,933
Slovakia	11,615	16,841	28,456
Cumulated Trade Turnover	114,654	147,013	233,211
UK, France, and Italy's cumulated export, import, and trade turnover with Visegrad countries			
	Export	Import	Export + Import
Visegrad Countries	50,807	80,514	131,321

Source: Author's own calculations, based on United Nations Commodity Trade Statistics, 2015

members.<sup>22</sup> When OBOR was launched in 2013, however, the 16+1 format became a de facto part of that initiative – widening the format's strategic horizon in scope and giving it a more distinctive geopolitical tone.<sup>23</sup>

While before the launch of the OBOR, CEE was seen largely as a bridgehead connecting to the EU's eastern edge, now China could begin to regard the CEE “sub-region” increasingly as a key bridge to link both the region and the EU at large into an interconnecting Eurasia.<sup>24</sup> Sustained cooperation in the transportation sector and a strong Chinese focus on connectivity support this statement. Even in this case, however, enhancing and strengthening connectivity and trade ties with a region where China is a relative newcomer (and Chinese companies barely know the market) still makes the EU and its regulatory instruments an indispensable partner for China. Considered from this perspective, even in a broader and more geopolitical scope, the 16+1 initiative and its Eurasian equivalent OBOR have the potential to engage and complement the EU while turning CEE into Europe's gateway to Eurasia. Whether or not this holds true will depend more on the EU than on China, however.

### An Emerging Trade Triangle: China and the German-Central European Manufacturing Core

In the long run, China's quiet but steadily rising penetration of CEE could indeed bear risks for the EU. It could exacerbate structural economic transformations already occurring inside Europe, widen geo-economic divisions, and eventually heighten political tensions between Germany on the one side and other European partners like France and Italy on the other regarding the future of the EU's political-economic architecture. Indeed, rather than consider the China-CEE relationship in *bilateral* terms, it is helpful to view it through a *triangular* prism of China, Germany, and the leading CEE economies. This highlights Germany's crucial role in trade relations with both China and the economically strongest CEE countries, particularly, Poland, Hungary, Slovakia, and the Czech Republic (collectively known as the Visegrad Group, or V4).

As Table 1 shows, in 2015 German trade with the V4 outpaced the cumulated trade of France, the UK, and Italy with the same four countries. The V4's trade with both Germany and other EU member states is mostly concentrated in mid to high value-added manufacturing goods (parts and components of vehicles, electrical machineries, and industrial machineries.)<sup>25</sup> This is largely intra-industrial trade. However, the much higher volumes of intra-industrial goods traded between V4 and Germany points to a much higher

concentration of cross-border manufacturing activity and supply chains in the German-Central-Eastern European sphere. As confirmed in different studies, there is increasing evidence for the emergence in this region of a “Central European Manufacturing Core,” a joint geo-economic production platform with Germany (and partially, Austria) at its center.<sup>26</sup>

In this German-Central European manufacturing core, integration in regional value chains and trade openness that followed the EU's enlargement in 2004 have helped the V4 maintain high manufacturing shares of GDP.<sup>27</sup> They have exceptionally profited from their vertical integration in Germany's supply and value chains, helping them accelerate their respective catch-up processes.

Conversely, it seems that global value chains have hastened “deindustrialization paths” in other advanced European economies like the UK, France, and Italy.<sup>28</sup> These have lost manufacturing and trade shares and have been suffering a prolonged period of stagnating growth following the European economic crisis as compared to both Germany and the V4 countries. For instance, the German-driven “core” alone produced 42 percent of the total EU manufacturing exports in 2011, when the European economic and debt crisis hit Italy and France particularly forcefully, accelerating their path of deindustrialization and trade contraction.<sup>29</sup> Against the backdrop of a structural shift out of manufacturing – one that is much less pronounced in Germany and the V4 than in countries like France, Italy, and Spain – an increasing divergence has also emerged in economic performance between the German-driven “core” and the Atlantic and Mediterranean “periphery.” This was amplified by the economic and financial crisis that began in 2008; from 2008 to 2014, GDP per capita in purchasing power parity has grown comparably stronger in both Germany and the V4 than in the stagnating economies of Atlantic and Mediterranean Europe, even though the V4 started from a considerably lower GDP level.<sup>30</sup>

When viewed against this backdrop, China's engagement in CEE gains a distinctive relevance. This becomes even clearer if we look at the distribution of China's trade with CEE by country and by product. In CEE, Beijing has clearly prioritized the countries that are part of the German-Central European manufacturing core.

Figures 1 and 2 show a great concentration of both investments and trade in at least three of the four Visegrad countries, where almost half of China's trade turnover with the region and half of its FDI are concentrated.<sup>31</sup> Of these, Poland and the Czech Republic are China's main trade partners in the region, while Hungary receives the

biggest share of FDI. The V4 countries already import from China complex, high value-added manufacturing goods (electrical machinery, mechanical equipment, and parts and components thereof) – more than they do from other big European countries, with the exception of Germany.<sup>32</sup> Meanwhile, while the EU as a whole still receives the largest volume of V4 exports – due largely to the intra-industrial trade with Germany's dominant economy – the V4's export and import trade with Asia has grown more dynamically. In it, China takes the lion's share both in imports and exports, with trade mainly concentrated in electronic machinery parts and components.<sup>33</sup>

As for Germany, the regional structure of its trade has been steadily shifting from Western Europe toward CEE and Asia. While the EU and the eurozone remain the main destination for German goods, ties with developing countries outside of the EU – particularly China – have grown much more dynamically than intra-European ties. Today, German trade with China outpaces trade between China and every other European advanced economy, with particularly strong manufacturing and intra-industrial trade.<sup>34</sup> As a result, in the first 11 months of 2016, China has become Germany's first trade partner, outpacing for the first time the United States and France. While the latter two are still the main destinations of Germany's exports, their position has been eroding in recent years.

On a year-to-year basis, for example, German exports to China rose by 5.5 percent between 2015 and 2016 as compared to a 1.7 percent decrease in exports to France and a 6.3 percent decrease in exports to the US in the same period. In terms of trade regions, the cumulated export share to both non-eurozone countries (which includes three of four Visegrad countries) and Asia (39.2 percent) is already higher than export to the eurozone (36.8 percent) and to America (12.2 percent).<sup>35</sup> This fact points to an increased German dependence on Asian and Chinese markets, which largely contributed to Germany's sustained export surpluses and growth performance compared to the rest of Europe.<sup>36</sup> Hence both Germany and the V4 have become much more independent of intra-European trade and domestic shocks.

Three factors in particular suggest the emergence of a triangular relationship: 1) China's increased (vertical) trade with both Germany and the V4, 2) the V4's sustained trade deficits with China, and 3) the region's high trade exchange and trade surplus with Germany. While the Visegrad countries mainly import computer and telecommunications devices from China, a rising portion of their imports consists of parts and components (such as electric motors or insulated wires and circuits for

both cars and industrial electrical machineries). While a more in-depth analysis of input-output data is needed for the analysis of a process that is only just beginning and whose data are hard to isolate, we can assume that a part of China's export in the V4 is increasingly processed in the regions' production chains, inputted as intermediate goods, mainly re-exported to Germany, and eventually exported from there as parts of finished products.<sup>37</sup> Hence, while this triangle is still in a very early stage, it seems that the V4 increasingly serves as an emerging production platform linking Germany with China and the rest of East Asia.

### Geopolitical Risks and Germany's Special Responsibilities

China's steadily increasing engagement in CEE is driven by an economic and geo-economic logic. This logic is not necessarily at odds with European interests, as Chinese investment in the region increases connectivity and fosters market integration. China's involvement in CEE, particularly through the "16+1" cooperation mechanism, does not follow a "divisive" strategy per se. Beijing shows little interest in weakening the EU per se and is aware of the extent to which it needs Brussels's stabilizing presence in a region where it is itself quite new on the scene. Indeed, Beijing's primary goal in CEE is to use the region as transportation gateway and commercial platform to Western Europe's markets in an effort to integrate the EU into its Eurasian grand strategy. Geopolitically, China's engagement in both CEE and Eurasia might give the EU, Germany, and CEE the chance to counterbalance Russia while increasing their own strategic, political, and economic leverage in Eurasia.

The developments call for wariness, however. China's inroads into CEE could become a dividing factor, one that may move the "German-Central Eastern European manufacturing core" away from the rest of the EU. This would involve the combination of several factors: 1) stagnating or slowly growing economies in Atlantic and southern Europe, 2) deepening divergences between Germany, France and (to a lesser extent) Italy, on the future of the EU's political economy, specifically on the role of public budget debts, public spending, economic competitiveness and export trade unbalances, 3) a deepening dependence of both Germany and the V4 on extra-EU and Asian trade, and 4) the convergence in this region of new China-sponsored Eurasian maritime and land routes. Taken together, these factors could indeed produce a stronger effect than China deliberately intends.

More broadly, without a coordinated strategy to engage China at both European and regional levels, the “inroads” China is making into CEE could amplify the challenges both Germany and the EU will have to face as Eurasian ties deepen and transatlantic and intra-European ties potentially weaken. Due to Germany’s crucial importance both inside and outside the EU, its government in particular must balance the different potential trade-offs carefully. Specifically, as the US under President Donald Trump becomes more inward looking and protectionist, negotiations on free trade agreements such as TPP and TTIP look less and less likely.<sup>38</sup> In post-Brexit Europe, Germany’s trade-friendly position may become more isolated if protectionism spreads to the weakening economies of Atlantic and Mediterranean Europe and relations with Russia remain strained. Against this backdrop, deepening ties to China could be seen as a natural option for both Germany and the Visegrad countries.

For Germany, China is a vital trade partner and final destination for its goods. Much more, it could potentially turn into a natural ally as it struggles to advocate open markets and free trade across the Eurasian continent and in Asia. China has already expressed its willingness to become the champion of open markets and free trade in the Asia Pacific region and in Eurasia, proposing a series of alternatives to the US-sponsored free trade agreements TTIP and TPP, which is now all but dead under Trump’s administration.<sup>39</sup>

Particularly in Eurasia, China could serve Germany as a geopolitical alternative to Russia. While it is widely understood that Moscow seeks to establish a strategic axis with Beijing as an alternative to Europe based on a “partnership among equals” to build a more integrated Eurasia, China, on the contrary, could well be skeptical of the idea.<sup>40</sup> Surely, in pursuing its goal of building a more integrated Eurasia, China must question the logic of partnering with an ailing and revisionist power intent on forging an “anti-Western” alliance that targets both the US and Europe. Much more, Beijing presumably sees advantages of strengthening its ties with the EU and Germany, as it needs both to realize its Eurasian project and modernize its economy.<sup>41</sup> Hence, strengthening economic and transportation ties along different corridors in CEE and across Eurasia is conducive to both German and Chinese interests.

Within Central Europe, nationalist governments such as those of Viktor Orban’s Fidesz party in Hungary and the PiS party in Poland increasingly oppose Brussels but continue to pursue strong economic ties with Germany in the short to middle run as part of the “manufactur-

ing core.” Where, then, do they stand on China? It is possible that Poland might be tempted to use China as an “external balancer” to both the EU and Russia, particularly if Russian-American rapprochement takes place under Trump. Warsaw might in the long run also hope to establish China as an alternative trade partner to Germany. Hungary or the Czech Republic, too, might follow the same path, seeing China as a less problematic political partner than Russia and economically a potential alternative to Germany and the EU.

## Conclusions and Recommendations

Chinese engagement in Central, Eastern, and South Eastern Europe could in the absence of a coordinated approach carry risks for Germany, for CEE countries, and for the EU as a whole. Any efforts by CEE countries to establish China as an alternative to Germany might prove a long-term task; residents of CEE might find themselves more and more dependent on Beijing, with trade deficits rapidly rising but without any guarantee that Beijing would commit to serving as an “external balancer” or offer an alternative to Germany’s stable, rule-based economic cooperation. For Germany, China’s attempt to move up along the manufacturing value chain and take advantage of the “digital revolution” could in the mid to long run turn Beijing into a powerful competitor on the global markets – and CEE into a contested geo-economic space between German and Chinese companies.<sup>42</sup> In fact, Beijing might try to turn CEE into its own production platform, further deepening divisions both inside the EU and, in the long run, in Germany’s relations with CEE. Against this backdrop, selling cutting-edge technological know-how to China without a clear regulatory and investment framework based on reciprocity could prove detrimental for Germany.

German policy makers could face a dilemma in this scenario. Siding with China and supporting open markets and free trade vis-à-vis the increasingly protectionist stance of both the United States and Western Europe would increase Berlin’s isolation and further weaken the EU’s institutions. If Germany instead became more protectionist vis-à-vis China, there could be substantial losses for German companies and, indirectly, for the CEE countries that are tied to them.

To counter such possible developments, Germany must start an ambitious and comprehensive triple-edged strategy. This should begin with greater engagement in CEE countries but should not be limited to the region:

First, it should work with CEE countries (especially the V4) as well as with other major European countries and EU institutions to forge a deeper and more effective cooperation with China in the CEE “common platform” for enhancing transport connectivity and economic modernization, particularly in the Western and Eastern Balkans. If the 16+1 framework fails to effectively include both the EU and Germany in common, concrete projects, then a consultative platform could be established involving the V4, China, Germany, and the EU in a “4+3” format. This could help set common rules and standards for joint investments that could, moreover, then serve as a benchmark in regions of Eurasia. A similar scope could serve the cooperation mechanism for the Western Balkans proposed by Germany in 2014 and which could be extended to China.

Second, within the framework of the planned EU-China investment agreement, Germany should increase its pressure on the Chinese government for further opening up the Chinese domestic market and guaranteeing Germany and the European Union access to China's companies and assets.<sup>43</sup>

Third, Germany should commit to an initiative at the EU level focused on new and forward-looking European industrial politics centered on the digitalization of value and supply chains, based on Germany's “Industrie 4.0” initiative and aimed to close the manufacturing gap inside Europe

In conclusion, Germany needs to approach Chinese involvement in Central and Eastern Europe with a multi-pronged, proactive strategy that simultaneously targets CEE, the EU, and China. Only if it does so will Germany be able to prevent intra-European divisions from deepening, take advantage of triangular relations with CEE and China, and foster mutually advantageous integration across Eurasia.

**Jacopo Maria Pepe** is associate fellow at the DGAP's Robert Bosch Center for Central and Eastern Europe, Russia, and Central Asia and is currently a visiting scholar and associate professor at the Edwin O. Reischauer Center for East Asian Studies at Johns Hopkins University's School for Advanced International Studies (SAIS).

## Notes

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