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## Levels of Sino-Croatian Economic Relations

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### *Summary*

This paper will give a comprehensive framework of the current Sino-Croatian economic relations. It will be primarily contextualised by Croatia's status as the newest EU member-state and by its membership in the China + 16 framework for political, cultural and economic cooperation. Taking stock of this new institutional framework is essential in order to understand both the potential and the limitations to Sino-Croatian economic relations. Therefore, we will address this issue by nesting Croatian foreign economic policy within three hierarchical layers: the layer of Croatian membership in the EU, the layer of the China + 16 framework and, finally, the layer of the bilateral relationship between the Republic of Croatia and the PRC. This reality is also confirmed by the recent statement by Kolinda Grabar-Kitarović, the President of the Republic of Croatia.

*Keywords:* Croatia, China, Foreign Economic Policy, China + 16, EU

### **Introduction**

Ever since the establishment of diplomatic relations and the official recognition of Croatia's statehood, the Republic of Croatia and the People's Republic of China (PRC) have had a rather significant economic and political exchange.<sup>1</sup> This has been predominantly represented in political contacts and closely followed by trade. On the other hand, investments and tourism have only started to gain traction recently. This paper will give a comprehensive framework of the current Sino-Croatian economic relations. It will be primarily contextualised by Croatia's status as the newest EU member-state and by its membership in the China + 16 framework for

<sup>1</sup> This paper was written within the 16+1 High-Level Academic Platform, established by Central Compilation & Translation Bureau of the Central Committee of the Communist Party of China and Poznan University of Economics and Business, and presented at the conference held in Warsaw on 20 and 21 October 2016.

political, cultural and economic cooperation. Taking stock of this new institutional framework is essential in order to understand both the potential and the limitations to Sino-Croatian economic relations. Therefore, we will address this issue by nesting Croatian foreign economic policy within three hierarchical layers: the layer of Croatian membership in the EU, the layer of the China + 16 framework and, finally, the layer of the bilateral relationship between the Republic of Croatia and the PRC. This is also confirmed by the recent statement by Kolinda Grabar-Kitarović, the President of the Republic of Croatia (Grabar-Kitarović, 2015). She claims that Sino-Croatian bilateral relations have been upgraded by cooperation under the banner of the EU-China dialogue and the recently launched China + 16 framework.

Given the prevailing structure of international relations and challenges emanating from the international arena, Christopher Hill (2003) identifies several potential avenues for envisaging a foreign policy that is appropriate for the context of small states such as Croatia. These are: multilateralism, specialisation in arenas deemed as a priority and the politics of quietism. The first two avenues can be easily paired with the first and the second layers of Sino-Croatian economic relations. Croatia's EU membership represents a multilateral context and the 'China + 16' or '16+1' framework covers the potential for specialisation in arenas deemed as a priority. This paper starts with the EU-China dialogue in order to determine the art of the possible in fostering closer economic cooperation between Zagreb and Beijing. The second part covers China + 16 and its impact on strengthening Sino-Croatian economic relations. Finally, the paper concludes by giving an overview of the Sino-Croatian bilateral economic relations since Croatia's independence.

### **The EU-China Dialogue and Its Impact on Sino-Croatian Economic Relations**

The EU represents a historical landmark in the attempt to establish a model of deep regional economic integration. Despite the progress in integrating many policy areas such as agriculture and trade policy, the EU does not share a common foreign economic policy.<sup>2</sup> The EU foreign economic policy can be modelled as a principal-agent (PA) approach. There is a long chain of delegation that incorporates several hierarchically organized PA relationships such as: interest groups and voters to national legislators, national legislators to executives, member-states to the Commission, voters and EU federations of interest groups to the European Parliament, the European Parliament to the Commission and, finally, the EU to international organizations (Dür and Elsig, 2011).

<sup>2</sup> Foreign economic policy covers multiple issues such as: international trade, international monetary relations, international financial policy, competition policy, development aid and the regulation of FDI.

This means the EU is still divided across geographical and sectoral lines, which is additionally exacerbated by the lingering impact of the eurozone's economic imbroglio. All of which, therefore, has to be taken into account when analysing both the EU's stance towards China and Croatia's role in the EU's foreign economic policy-making. The EU member-states' stance towards China can be grouped into four distinct clusters based on two criteria: economic attitude and political attitude. There are two diametrically opposed outcomes on the scale which measures the economic attitude: protectionist and liberal. On the scale which portrays the political attitude we can distinguish another two outcomes: supportive and critical (Fox and Godement, 2009). When combining the two criteria and their subcategories we can indicate four clusters:

**1. Assertive Industrialists.** This group encompasses countries with a more critical stance towards the PRC along both dimensions, the economic and the political. In this group we can enlist Germany, Poland and the Czech Republic.<sup>3</sup> This group is more open to criticizing human rights issues and is also more vocal in stressing the need to be tough on China's infringement of intellectual property rights (IPR), as well as on the lack of China's emphasis on more liberal trade and investment in the international order. The common denominator for those countries is the critical view of the EU's rather unconditional engagement with the PRC.

**2. Ideological Free-traders.** This group subsumes the likes of Sweden, Denmark, the Netherlands and the United Kingdom.<sup>4</sup> They are ready to pressure China on political issues, but are reluctant to endorse the imposition of restrictions on trade. Those countries are specialised in exporting services and perceive their opportunity in that particular sector. Therefore, they are not so keen on criticising China's trade-distorting practices in the manufacturing sector.

**3. Accommodating Mercantilists.** These countries steadily point out the growing EU-China trade deficit. After EU consumption picked up in 2014, the EU's trade deficit with China increased by an additional 5.9 billion EUR from 2013 to 2014 (Bendini and Barone, 2015). The EU's overall trade deficit with China amounted to 137.8 billion EUR in 2014 (*ibid.*). In light of these facts, countries such as Italy, Spain, Greece and Portugal are advocating for a tougher stance towards the

<sup>3</sup> The attachment to a particular cluster is not cast in stone and it is a rather fluid process, dependent on the internal political context of each given EU member-state. The case of the Czech Republic illustrates this point. Ever since Miloš Zeman took over the Czech Presidency, he has been keen on fostering closer ties with China and Russia as opposed to the EU and the US. Chinese intelligence has been building influence in Czech political circles and this could be linked with a change in Czech foreign policy trajectory (Muller and Lopatka, 2016).

<sup>4</sup> It is to be seen how the Brexit will play out in the heated debate between protectionist and liberal blocs of countries within the EU.

issue of granting China 'market economy status'. At the same time, these countries are more willing to refrain from criticising China on political issues, in order to secure China's benevolence in improving their market access.

**4. European Followers.** In the last group we can lump together the countries that do not consider their relationship with China as a very important pillar of their foreign economic policy. These are: Austria, the Baltic countries and Ireland. They are rather followers than agenda-setters when it comes to the EU-China dialogue.

When analysing Croatia's position within these four different clusters, we can undoubtedly conclude that Croatia represents a European Follower. This conclusion could be partly inferred from the data on bilateral trade measures against China's exports, as evidenced by the WTO's Integrated Trade Intelligence Portal, and by relying on the voting record of the European Parliament and the Council of Ministers. At the moment, there are no bilateral trade measures against China, while some Central and Eastern European countries such as the Czech Republic and Slovenia have at least one measure directed at China's exports (World Trade Organization, 2016). In its trade relations with China, Croatia applies only common EU protectionist measures. When it comes to the political attitude on granting China 'market economy status' (read: stripping off import duties), all Croatian members of the European Parliament recently voted in line with their party groups' dominant position, which puts them in the category of European Followers.<sup>5</sup>

Before advancing to Croatia's impact on the EU's external position vis-à-vis China, it is essential to briefly outline the basic tenets and frictions in current EU-China bilateral relations. We will start with investments and public procurement. Despite the recent launch of bilateral negotiations on a common investment regime, the talks between the EU and the PRC have not produced considerable progress

<sup>5</sup> The issue at stake was labelling China as a 'market economy' which eliminates the authority to use certain trade protection measures on the part of EU member-states. The amendment to the joint motion of the European Parliament which explicitly requires that the EU should withhold from granting China the aforementioned status, even if China does not satisfy the EU criteria for defining the market economy, was voted down by the majority of MEPs (VoteWatch, 2016). The EPP and ALDE groupations were against the motion, while Socialists abstained from taking a firm position. Despite the fact that not all centre-right Croatian MEPs are staunch advocates of freer trade with China, they decided to follow the main chorus line of their respective party families. Croatian Social Democrats abstained and HDZ/EPP members sided with the majority of CDU/CSU and ÖVP members, despite cleavages present within the German and Austrian parties. Those cleavages can be explained by different cross-sectoral impacts of trade liberalising measures and the political mobilisation to oppose them. Given the absence of this kind of bottom-up mobilisation and cleavages in the case of Croatia, one can certainly conclude that China-pertaining issues do not achieve high political salience in Croatia as compared to the majority of EU member-states. This absence of internal divisions provides an explanation for why we put Croatia in the category of European Followers.

since 2014.<sup>6</sup> This comes in spite of an upward trend in China's investments into EU economies, which have averaged more than 10 billion EUR in the period since 2010. Those investments are a growing testimony to the new long-term structural trend in EU-China relations (Baker&McKenzie, 2015). Lacking any major breakthrough with regard to the investment regime, the Chinese side tried to step up its negotiating position by proposing a completely new dimension of economic cooperation. This was epitomised by the initiation of a comprehensive EU-China Free Trade Agreement during President Xi Jinping's historic visit to Brussels in 2014.

However praiseworthy, the proclaimed interest in boosting trade is not paired with the bidirectionality of investment flows, whereby both sides put an equal emphasis on the principle of reciprocity. Regrettably, there is an obvious asymmetry in the current openness to clearing investment hurdles. Supported by the vast sums of state capital, Chinese companies can buy the likes of Volvo, Syngenta and Pirelli, but the takeover of China's large companies still remains elusive to European investors. On the other hand, 80% of the EU's public procurement is open to international competition while the figure for China is estimated at only 14% (Godement, 2016). Unfortunately, the EU currently has only a limited amount of negotiating capital and resources for the prospective EU-China agreement, since it is highly committed to the ongoing TTIP negotiations.<sup>7</sup>

Besides bilateral investment flows and public procurement, the EU is also confronted with the contentious issue of granting China the highly prized 'market economy status'. Under the existing framework of China's accession to the WTO in 2001 (Protocol 15), there is a 15 years transition period within which WTO members are allowed to effectively deny the 'market economy' treatment. One of the main reasons for the reluctance on the part of EU policy-makers to unleash free trade flows is their experience with China's slow transition to market-based mechanisms in conducting economic policy, ever since its WTO accession in 2001. Furthermore, many NGOs, trade unions and sectoral producers such as Eurofer complain that the change of policy stance would inadvertently backfire on EU's economy and consumers. Giving up some steep tariffs in sectors such as ceramics, steel and textile would additionally aggravate the current economic malaise of countries where most of those industries are located: Spain, Italy and France (Steinbock, 2016).<sup>8</sup>

<sup>6</sup> China's approach to regulating investments is still primarily bilateral.

<sup>7</sup> The EU's negotiating focus will be even narrower in the coming years given the recent decision of the majority of Britons to vote for Brexit. This does not augur well for achieving progress on the aforementioned issues.

<sup>8</sup> Croatia has a similar economic structure to other Mediterranean economies. Therefore, the garment, furniture and footwear industries are protected by the common EU tariffs and anti-dumping measures.

At the moment, anti-dumping measures are applied to Chinese exports in sectors well-known for their overcapacity, such as ceramics, solar panels, steel, textiles and apparel. The WTO's Integrated Trade Intelligence Portal shows that the EU has imposed a total of 67 anti-dumping and 5 countervailing measures related to China's export to the EU. The EU also identified 14 Sanitary and Phytosanitary (SPS) and 24 Technical Barriers to Trade (TBT) issues as Specific Trade Concerns with China. On the other hand, China put in force 20 anti-dumping and 2 countervailing measures to EU imports. One must also add 51 Specific Trade Concerns on behalf of China's industries to the list (World Trade Organisation, 2016).

According to the *Economic Policy Institute* report, there are 1.7 to 3.5 million EU jobs at risk from unilaterally relinquishing the authority to use anti-dumping and anti-subsidy measures under the banner of targeting non-market economy practices (Scott and Jiang, 2015). The study also envisions the flood of Chinese imports into the EU to the tune of 142.5 billion EUR by 2020 (AEGIS Europe, 2016). In this paper, it is especially important to note that the *EPI* report states that the six worst affected countries in terms of job loss relative to the size of their economy are the main Eastern European member-states (Poland, Czech Republic, Bulgaria, Romania, Hungary and Slovakia).<sup>9</sup>

In spite of being designated as a market economy by developed countries, such as Switzerland, Australia and New Zealand, the EU holds a common line with the US and Canada. To be considered a 'market economy', the EU requests that the following set of criteria be fulfilled: a country must have a floating exchange rate, a free market, a non-intrusive government, effective business accounting standards and, lastly, a clear definition of property rights and bankruptcy laws (Bendini, 2014). In spite of the Chinese leadership's incantations of major structural reforms at the Third Plenum of the 18<sup>th</sup> Central Committee in 2013, China has not delivered on the reforms pertaining to the criteria deemed essential for granting the country 'market economy status'. Therefore, the EU is currently straddling a very challenging political terrain since it is confronted with the issue of protecting domestic industries and upholding international treaties, regardless of their ambiguous formulation.<sup>10</sup>

<sup>9</sup> Unfortunately, Croatia is not included in the *EPI* report, so there are only wide guesses of the full impact of China's increased exports if its non-market economy status were to be revoked. Nevertheless, this does not bode well for Croatia's import-competing and export-oriented producers in sectors that are in competition with China.

<sup>10</sup> Chinese authorities primarily put the emphasis on lobbying activities instead of on making some significant liberalising economic reforms at home. Their goal is targeting the EU's specific multilevel governance form, using member-states as a key access point. This strategy should result in mollifying the EU's common position (Kratz, 2016).

There are several scenarios of how this EU-China quandary could play out. The first scenario could be described as doing nothing. If the EU abstained from granting China 'market economy status', China would challenge this decision in a legal dispute before the WTO, a scenario that would almost certainly result in a deterioration in bilateral relations (Kratz, 2016). This may even lead to the escalation of tariffs, stoking a trade war. The second scenario implies the decision that China be qualified in the league of market economies, but without mitigating measures to stem the flow of heavily subsidised Chinese goods. The third scenario of how to overcome this impasse is for the EU to grant China 'market economy status' while at the same time implementing a major reform of its trade defence instruments. This scenario would establish a firm WTO-proof trade regime affecting all countries, including China. Literally, this means identifying a list of justified reasons to label some countries' exports as those produced in the absence of a level-playing field. The aforementioned framework would be able to deflect China's complaint of being treated in a discriminatory fashion.

Therefore, it seems plausible that the EU will persist with its anti-dumping policy even beyond 2016, but in a legally sounder form. However, the revision of its trade policy framework is inevitable. As already stated above, the EU is caught between the task of protecting its economies and the need to attract Chinese investments. The potential for further progress in trade issues definitely exists. However, apart from the revamped trade defence regime, the EU could insist on long-term financial flows from China to compensate the losers of a more open trade, as well as on a major overhaul of China's economic policy. Only after observing this kind of improvement could it be sensibly expected that both the European Parliament and the Council of Ministers would eliminate the remaining trade disputes.

Despite of all the aforementioned obstacles, the bilateral trade relations between China and the EU have been generally good. The EU has become the biggest importer of China's goods to the tune of 1 billion EUR per day (European Commission, 2016). Meanwhile, the trade in services lags behind with a significantly lower volume, but with an upward trend. In terms of investments, the EU invests only 2-3% of its yearly outward flow to China, while China has been stepping up its EU investment efforts in the last 4 years (Bendini and Barone, 2015). The overall quality of EU-China bilateral economic relations can be inferred from the *European Foreign Policy Scorecard 2015* (ECFR, 2015). It provides a glimpse into the EU-China dynamics during the 2010-2014 period. While some areas mark a slight progress such as the formats of Europe-China dialogue and investments & market access in China, the overall picture looks more or less the same during the whole period under comparison.

After this extensive elaboration of the wider EU-China framework, we have to position Croatia within these confines. As already discussed above, the Republic of

**Table 1.**

CATEGORY	2014	2013	2012	2011	2010
<b>1. Formats of Europe-China dialogue</b>	B-	B	B-	C+	C+
<b>2. Investments &amp; market access in China</b>	B	B+	B-	B-	B-
<b>3. Overall partnership</b>	B-	B	C+	C+	B-

Source: European Foreign Policy Scorecard 2015

Croatia can be categorised as a European Follower in terms of its foreign economic policy towards the PRC. Its agenda-setting power is seriously curtailed and we provide a twofold explanation. There are two important factors for effectively bringing China-related issues to the joint table in Brussels. Firstly, the degree of power and influence at the level of the European Council and the Council of Ministers. Secondly, the degree of identification of China-related issues as important at the level of national polity.

In order to elucidate the first factor we start with the recent empirical study on the power matrix in the EU. The central question of this study points to the degree in which national political leaders are effective at combining forces with their ambassadors to the EU, to ensure power and influence (Heath, 2016). The matrix displays that Croatia is the least politically influential EU member-state. Effectively, this translates into Croatia's lack of a meaningful voice on important internal EU issues, as well as on issues which encompass EU relations with third countries. For the sake of identifying the second factor we stress the level of identification of China-related issues as important in the domestic political arena. When analysing political manifestos of all Croatian parliamentary parties, none of them, apart from the party *Živi zid*, mentions any issue pertained to Sino-Croatian relations. Unfortunately, *Živi zid*, a populist party with only one representative in the Croatian Parliament, has been very far from taking any kind of systematic approach to China. It only claims that Croatia should mirror China's policy of RMB devaluation in order to boost its competitiveness.

Even in the ideal case of having more foreign policy leverage in Brussels and raising the level of awareness about China-related issues in the Croatian political arena, Croatia would face the same dilemma as all other EU members. On the one hand, by forging very intensive and warm bilateral ties with China, each member-state may acquire gains with regard to China's investments or increased export possibilities (Fox and Godement, 2009). However, the lack of a coherent EU-wide strategy towards China undermines the EU's common position on many issues such as trade disputes, an investment regime, global governance, climate change and human rights.



It also has the potential to engulf EU member-states in a fierce competition to bid for China's resources, while limiting their collective bargaining power (*ibid.*). Therefore, the EU membership as a framework for Croatia's foreign economic policy sets the tone and limits what is politically feasible on many important issues. Hill's (2003) emphasis on multilateralism in case of small states gives a good foreign economic policy guidance. The Republic of Croatia cannot single-handedly grant 'market economy status' to China or sign a special bilateral investment treaty without having in mind the need for a common EU approach to bargaining with the PRC.<sup>11</sup> Nevertheless, there are many areas where Croatia could profit from a more frictionless cooperation with China. The following sections provide a glimpse into the arenas and issues where Croatia's foreign economic policy can leverage its position.

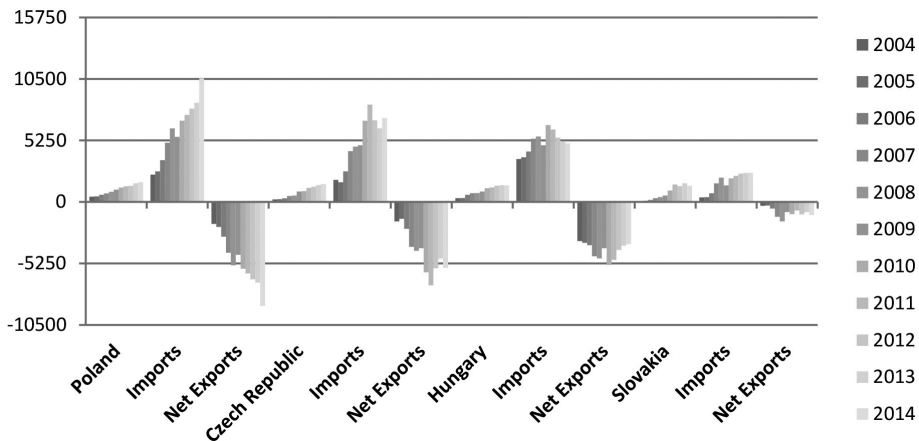
### **The China + 16 Framework and Its Impact on Sino-Croatian Economic Relations**

The China + 16 framework refers to various mechanisms and arrangements between China and 16 Central and Eastern European countries (CEE countries) that was established after Premier Wen Jiabao's visit to Poland in 2012. Subsequently, the China + 16 cooperation framework has helped to deepen mutual political trust, build cooperation mechanisms and frameworks, and develop practical collaboration among all parties (Minru, 2015). The main advantage of this cooperation framework is its loose form (Tianping, 2015). Nevertheless, some critics argue that the current framework is similar to the Forum on China-Africa Cooperation (FOCAC), "a front of nice speeches, and deals that are purely bilateral as opposed to regional" (Godeмент, 2016: 9). Regardless of its current format and future trajectory, China + 16 builds on the already existing intensification of trade and investment ties between CEE countries and China. We illustrate this in *Figures 1, 2, 3 and 4*.

It is clearly observable that China has trade surpluses with all of the above-mentioned countries. Only Slovakia, Hungary, Croatia and Bulgaria have had some success in recently curbing trade deficits with China. All countries except Croatia imported more goods from China in 2014 than in 2004. Croatia more than halved its imports at the time when it was on its way to becoming an EU member (Garlick, 2015). Nevertheless, Croatia's reduced imports from China could be overestimated due to the substitution of direct imports from China with imports of Chinese goods from other EU countries. On the other hand, Slovakia's stark increase in exports to China overestimates the share of Slovakian merchandise due to German carmakers'

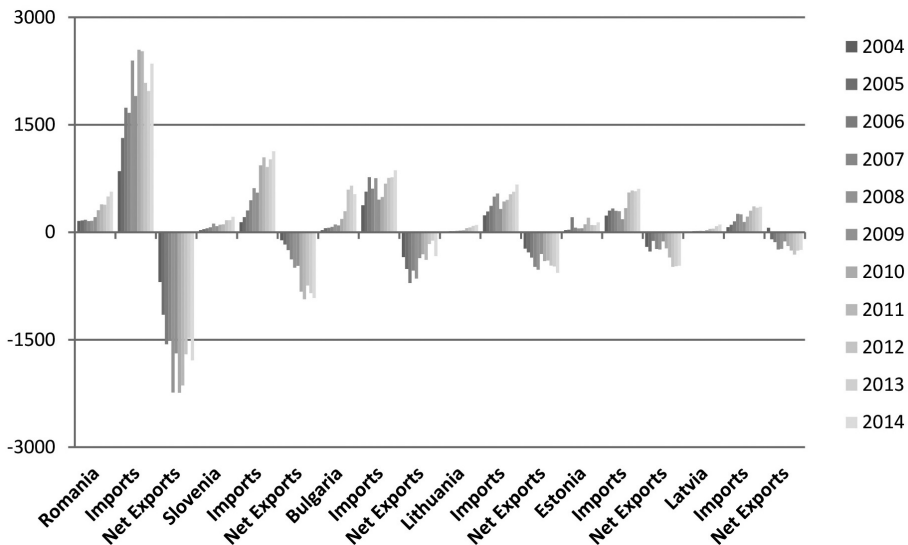
<sup>11</sup> As already noted at the outset, small states can reap significant benefits from relying on a multilateral approach.

**Figure 1.** China's Trade with Višegrad Group Countries (in millions of euros)



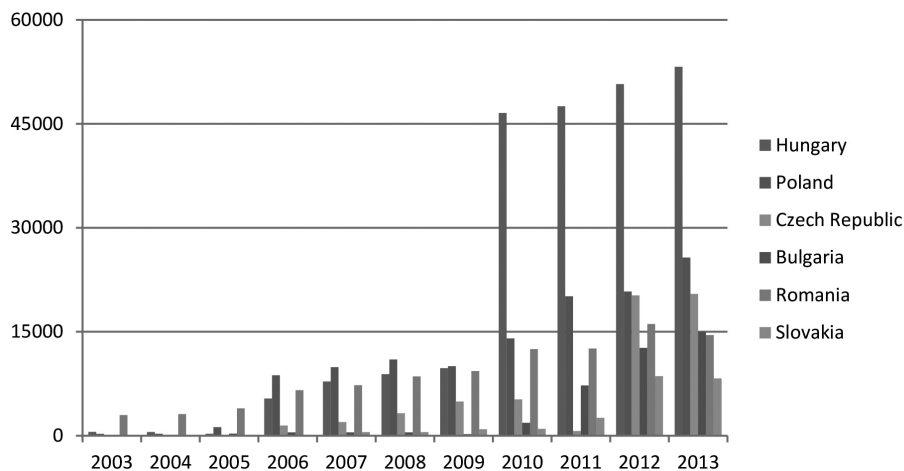
Source: Eurostat

**Figure 2.** China's Trade with Other EU Countries which Fall into the CEE Group (in millions of euros)



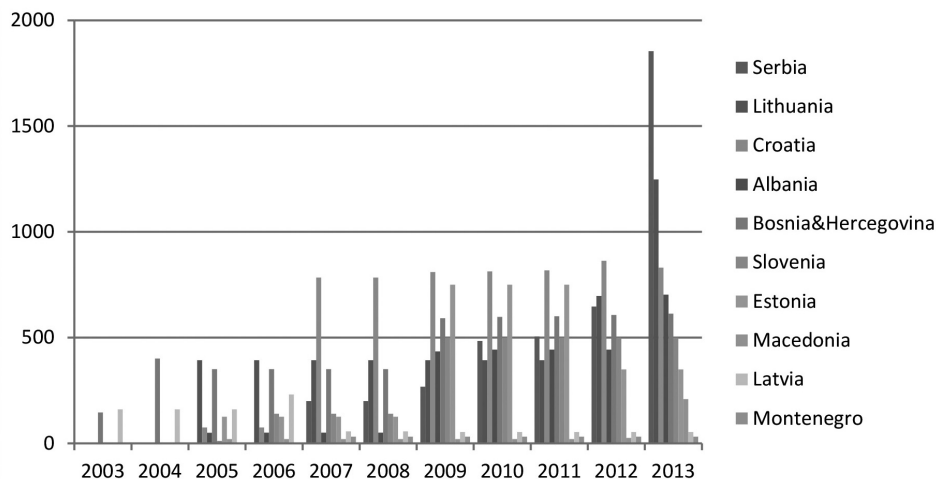
Source: Eurostat

**Figure 3.** China’s FDI Stock in 6 Countries with the Biggest Investment Inflow (1 unit = 10000 USD)



Source: Tianping, 2015

**Figure 4.** China’s FDI Stock in the Remaining 10 CEE Countries (1 unit = 10000 USD)



Source: Tianping, 2015

presence in that country. Therefore, trade balance figures should take into account the peculiarities of modern trade statistics.

China's implementation of the China + 16 formula for meetings includes the CEE11 plus Serbia, Macedonia, Bosnia and Herzegovina, Montenegro and Albania. Some analysts point out that this strategy has *de facto* created a new grouping that straddles EU and non-EU states in a way that tends to negate the EU's leverage on China's negotiations with those states. Nevertheless, some authors suggest that China is not that much interested in weakening the EU as a pillar of the multipolar world order. On the contrary, China is keener on strengthening the China + 16 framework or on picking partners with a more pro-EU stance, than on choosing EU rebels as allies in the quest of dividing the EU (Turcsanyi, 2014).<sup>12</sup> As a part of its 'going out strategy' Chinese foreign policy obviously prefers countries with solid economies, an excellent ratio between quality and the cost of production, stable governments and a good stance in the EU (Garlick, 2015). Ideological and political underpinnings of cooperation play a less prominent role.<sup>13</sup>

The analysis of potential synergies between China and CEE countries offers some tentative conclusions. Firstly, China is trying to align the Belt and Road Initiative with CEE countries development priorities. Chinese infrastructure investments and the Juncker plan offer considerable synergies for booming commerce, tourism and investment flows. This is also compatible with the Baltics-Adria initiative (Grabar-Kitarović, 2015).<sup>14</sup> The construction of major transportation corridors would further integrate the Euroasian landmass and markets. The most recent example refers to the DHL Global Forwarding, which launched a weekly intermodal service from Suzhou to Warsaw.<sup>15</sup> Secondly, both sides lack the knowledge of vital

<sup>12</sup> Hungary's attempt at leveraging fast rapprochement with China in 2012 against the EU's pressure on Prime Minister Orban's practices was not greeted enthusiastically by China.

<sup>13</sup> According to Li Zuokui, the Head of Research at the CEEC Research Institute Europe, and the Chinese Academy of Social Sciences, there are several important obstacles to cooperation between China and CEE countries. These are: the difference in ideology; differences in the level of development; debt and refugee crisis hitting the EU; the heavy reliance of CEEC on the US and the EU, which implies the need for China to pay attention to these strategic realities and, finally, risks such as the spectre of terrorism threat in Europe (China Radio International, 2015).

<sup>14</sup> The Adriatic – Baltic – Black Sea Initiative was first put forward by the Croatian President Kolinda Grabar-Kitarović in September 2015. It should be viewed as a framework for enhanced cooperation in political, economic and security areas among 12 EU member-states in Central and Eastern Europe. Chinese president Xi met with President Grabar-Kitarović in Beijing and welcomed the Adriatic – Baltic – Black Sea Initiative. He also stressed that the development of the North – South corridor within the EU is complementary to China's One Belt, One Road strategy.

<sup>15</sup> The journey lasts 14 days, it takes half the time of ocean freight and is one sixth of the cost of air freight (Railway Gazette, 2014).

business culture and practices. In this sense, the plethora of different cooperation platforms raises the prospect of enhancing social capital and expanding social network.

The China + 16 framework relies on annual summits of prime ministers. This year will mark the sixth summit which underlines the continuity of mutual exchange. National coordinators are crucial in the summit preparation and they play the role of so-called *sherpas*. It is also worth mentioning the China + 16 Economic Trade Forum which is held annually. As noted before, China + 16 offers the advantage of *ad hoc* cooperation on a voluntary basis. The possibility of specialisation in arenas deemed as priorities is one of the key leverages in small states' foreign policy (Hill, 2003). Bearing that in mind, it is crucial to point to the role and diplomatic activity of the Republic of Croatia in the China + 16 framework up to the present.

The former Croatian Prime Minister Zoran Milanović attended the Warsaw Summit in 2012, as well as the Bucharest Summit in 2013. In Bucharest he met with Chinese Prime Minister Li Keqiang who congratulated Croatia on becoming the 28<sup>th</sup> EU member-state and expressed his expectation that Croatia would play a positive role in promoting China-EU relations, as well as cooperation between China and the CEEC. Milanović remarked that Croatia and China had enjoyed a close cooperation and that Croatia was willing to take the advantage of its geographical position to enhance cooperation with China. This refers primarily to the area of transportation infrastructure so as to promote regional economic development (Cooperation between China and Central and Eastern European Countries, 2016). However, the Croatian Prime Minister was not present at the Belgrade Summit in 2014. The main reason for this absence was the Prime Minister's dissatisfaction with the stance of Serbian authorities toward provocations uttered by the leader of ultra-nationalist Serb radical party, Vojislav Šešelj. Instead, Croatia's First Deputy Prime Minister and the Minister of Foreign and European Affairs Vesna Pusić attended the Belgrade Summit. In November 2015 the 5<sup>th</sup> 16+1 summit ensued in Suzhou, China. Again, ex-Prime Minister Milanović was absent and had sent Josip Leko, the then Speaker of the Croatian Parliament, as an envoy.<sup>16</sup>

<sup>16</sup> After failing to attend the Belgrade summit, the Prime Minister Milanović declared that he had attended the first two summits out of politeness and that he would have had attended the third one, only if "it were not for these matters that took place during the last few days". There was also an interesting remark that during 16+1 meetings the political dialogue takes precedence over detailed negotiations on substantive issues, as well as that no major Chinese investments had made inroads into Croatia. He stated that the main problem identified by the Croatian side is that contracts are gained by public tenders according to the EU rules, and that Chinese investors had not applied for them since they expected to obtain projects in the course of political negotiations.

Unfortunately, when it comes to the potential of carving up a niche or specialisation within the 16+1 framework, Croatia's diplomatic activity seems pretty lame and reactive. None of the initiatives based on the functional division of cooperation tasks has been launched by Croatia. For instance, Serbia will set up a China-CEEC Federation of Transport and Infrastructure Cooperation. The executive office of the China-CEEC Joint Chamber of Commerce will be stationed in Warsaw, and the secretariat of the China-CEEC Contact Mechanism for Investment Promotion Agencies will be established in Beijing and Warsaw. Bulgaria will host the China-CEEC Federation of Agricultural Cooperation; The Czech Republic will host the China-CEEC Federation of Heads of Local Governments; and Romania took the initiative to set up a China-CEEC Centre for Dialogue and Cooperation on Energy Projects (Tianping, 2015). The only improvement in the level of Croatian engagement with the China + 16 framework, as compared to the period from 2012 to 2015, points to the hosting of the 3<sup>rd</sup> China-CEEC High-Level Conference on Tourism Cooperation in 2016. The *Suzhou Guidelines for Cooperation between China and Central and Eastern European Countries* provide evidence for this particular conclusion (Ministry of Foreign Affairs of the People's Republic of China, 2016).

This year's summit in Latvia will show whether the Croatian side is ready to pay more attention to the China + 16 framework, either with the participation of the Croatian Prime Minister or the President of the Republic. The appointment of a new Croatian national coordinator for the framework is also of vital importance.<sup>17</sup> The former government spent more than 100 days in office without solving this pressing issue. It is to be seen whether new elections in September will quickly lead to the formation of a stable government dedicated to the China + 16 framework. The government's instability clearly hampers active engagement on the part of Croatian policy-makers with the China + 16 framework and shows that Croatia's foreign economic policy towards China is lagging.

As a conclusion to this section we claim that there are many opportunities for Croatia to tap into the China + 16 cooperation framework, especially in the domain of investments and trade. Only the reliance on a closer coordination with neighbouring countries carries the potential for attracting more Chinese FDI to Croatia. This is feasible both for infrastructure and greenfield/brownfield investments due to their proximity to the Western European market. The analysis of benefits of a closer cooperation between Central and Eastern European countries on China-related issues points to the advantage of reduced transaction costs and lower entry barriers if these costs are to be split among various partners. If faced with obstacles of low quantities or high entry barriers when entering China's market, it makes sense to

<sup>17</sup> The new national coordinator is Leo Prelec, the Deputy Minister of Economy in Orešković's technical government.

pool resources at multiple levels. Thus far, Croatia has shown noticeable reluctance to commit more to the active engagement with and within the framework. This can be inferred both from the rank of officials sent to the annual China + 16 summits and the number of initiatives undertaken by Croatian diplomacy. Consequently, the China + 16 framework represents an under-utilised avenue for improving Sino-Croatian economic relations.

### Sino-Croatian Economic Relations Since Croatia's Independence

Ever since the *Joint Communiqué on the Establishment of Diplomatic Relations between the Republic of Croatia and the People's Republic of China*, Croatia and China have cultivated their bilateral economic cooperation. One of the forerunners of this cooperation is represented by the partnership of INA and Sinochem in supplying Croatia with petrol during the Homeland War (Baković, 2006). Many bilateral business contacts proliferated afterwards, were followed up by the formal institutionalisation of bilateral economic relations. There exists a mechanism of the Sino-Croatian Joint Committee for Economy and Trade between the governments of China and Croatia. China and Croatia have signed the following agreements: *Agreement on Economy and Trade*, *Agreement on Reciprocal Promotion and the Protection of Investments*, *Agreement on Avoiding Double Taxation and the Prevention of Tax Evasion*, *Memorandum of Understanding between Croatia and China on the Establishment of a Croatian – Chinese Economic and Technological Zone*, and many others (Embassy of the People's Republic of China in the Republic of Croatia, 2014).

According to the index of political-diplomatic importance, China nominally plays a very important role in Croatian foreign policy. The index consists of five indicators: 1. the existence of a Croatian diplomatic mission; 2. the existence of a Croatian consulate; 3. the existence of signed bilateral agreements and acts; 4. the existence of inter-parliamentary friendship groups between Croatia and a particular country; 5. state visits, the highest expression of friendly relations between two sovereign states, in this case visits of the Croatian presidents, prime ministers or ministers of foreign affairs (Kos-Stanišić, 2010). An overview of Sino-Croatian diplomatic relations is given in *Table 2*.

**Table 2.** Political-diplomatic Significance of the PRC to Croatia (1992-2012)

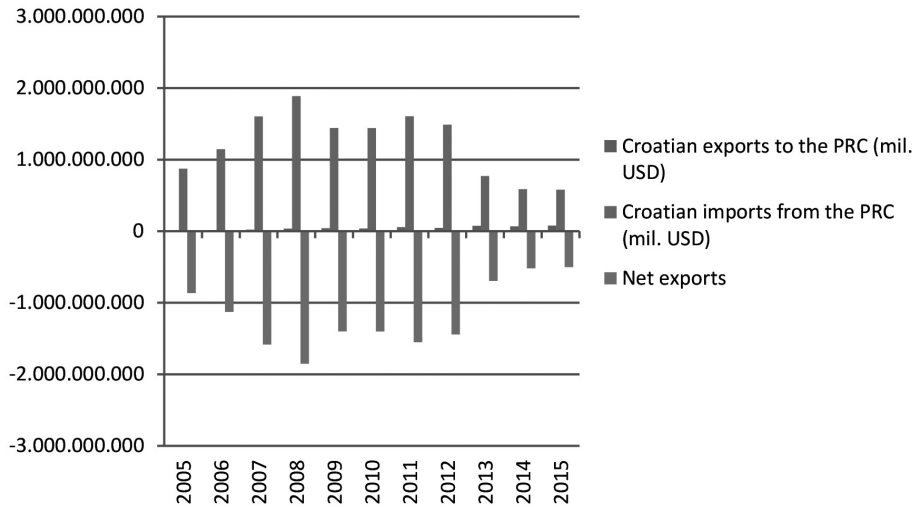
Country	Republic of Croatia Embassy	Republic of Croatia Consulate	Bilateral agreements	Inter-parliamentary friendship groups	State visits
China	Yes (Beijing)	Yes (Hong Kong)	Yes (44)	Yes (2001)	Yes (9)

Regardless of the presence of all five indicators in Sino-Croatian bilateral relations, China is not significantly anchored as a reference point for Croatian policy-makers. The lack of focus towards China is evident when analysing the sample of 23 Croatian strategic documents for the keyword 'China'. The sample closely tracks key areas under purview of key Croatian ministries. We only found 'China' in two strategic documents: the Tourism Development Strategy and the Transport Development Strategy. On the other hand, strategic plans of the Ministry of Foreign and European affairs for the following periods: 2013-2015, 2014-2016, 2015-2017 and 2016-2018 show that China is only mentioned in the plan for the period between 2013-2015. However, this occurred solely in the context of referring to the BRICS formation. Notwithstanding the fact that China enjoys a very significant place in Croatian foreign policy, if assessed by the high score on the index of political-diplomatic importance, this advantage is not translated into intensive cooperation in bilateral economic relations.

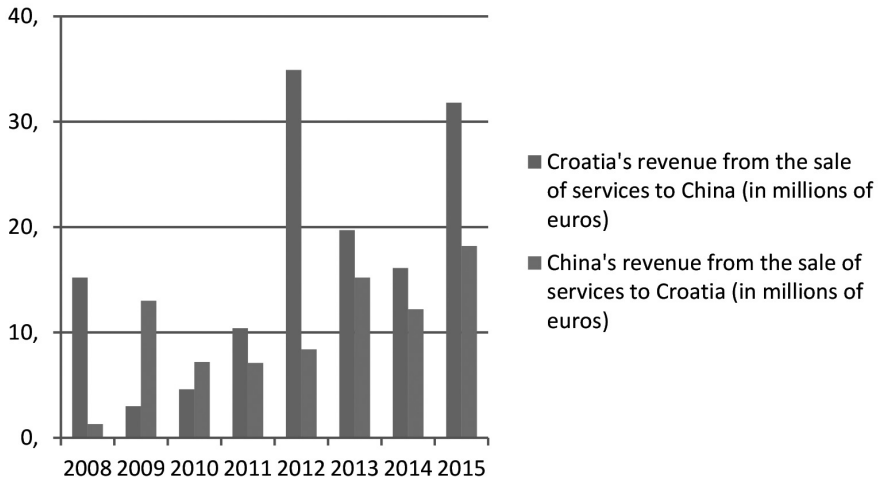
In the domain of trade, China is still not among the top 20 Croatian export markets. In terms of imports, China was Croatia's 8<sup>th</sup> import partner in 2014 (The Observatory of Economic Complexity, 2016). This should be contrasted with the fact that China has been the top export market for 43 countries in the world (Holodny, 2015). The trading potential between China and Croatia is heavily under-utilised on the part of Croatian exporters. This is reflected in the constant trade deficit in goods from 2005-2015. On the other hand, Croatia incurs a healthy surplus in selling services, especially due to the influx of Chinese tourists to Croatia. There is a great potential for growth in tourism, especially when the number of Chinese guests and nights spent is compared to incoming tourists from Japan and South Korea (*Table 3*). Thus far, the trade deficit has not been narrowed by revenue from trade in services, which points to a steady current account deficit. We illustrate this in *Figures 5* and *6*, as well as *Table 3*. Croatia's biggest export items regularly include machines for processing leather and rubber, as well as timber (Croatian Chamber of Economy). It is important to maintain the country's presence in these market niches. The biggest potential for Croatian exports lies in tourism, and the food and beverage processing industry, IT and furniture. Apart from boosting the trade volume, there is also a potential to improve the structure of trade. Further diversification and a move towards more value-added items is particularly desirable. The Croatian Chamber of Economy plans to open up its representative office in Shanghai by the end of 2016. This constitutes a move in the right direction. The planned Sino-Croatian coordination could span joint public and private initiatives in various sectors.

Speaking of investments, Croatia is in the group with Slovakia, Slovenia, Cyprus, Malta, Latvia, Lithuania and Estonia, with less than 100 million USD of Chinese FDI in 2014. In 2014, less than 5% of China's investments into the EU were concentrated in the CEE 11 countries. Several Chinese investors have announced



**Figure 5.**

Source: Croatian Chamber of Economy

**Figure 6.**

Source: Croatian National Bank

**Table 3.**

	Foreign tourists in 1000				Nights in 1000			
	2012	2013	2014	Index 2013/2014	2012	2013	2014	Index 2013/2014
<b>People's Republic of China</b>	43	42	61	145,2	64	63	89	141,3
<b>Japan</b>	155	159	177	111,3	220	221	247	111,8
<b>Republic of Korea</b>	47	74	264	356,8	62	98	328	334,7
	Domestic tourists in 1000				Nights in 1000			
		2013	2014	Index 2013/2014		2013	2014	Index 2013/2014
<b>People's Republic of China</b>	1371	1368	1350	98,7	11177	11136	10796	96,9
<b>Japan</b>	85	95	110	115,8	549	539	1344	249,4
<b>Republic of Korea</b>	No data	No data	No data	No data	No data	No data	No data	No data

Source: Croatian Tourist National Board

large scale greenfield projects in Central and Eastern Europe in recent years, but the progress has been slow to date. A case in point is the China International Investment Stock's joint venture for building a paper mill in Croatia (Baker&McKenzie, 2015). Obviously, on the one hand, there is much talking and wishful thinking on the part of Croatian media and politicians about Chinese investments in Croatia. On the other hand, the investment terms required by China are often structured in such a way that only the non-EU members, free of EU rules, could avail themselves of the offers (Godement, 2016). The EU's competition policy dissuades any attempt of skewing the level-playing field by attracting investments with the carrot of subsidies, state guarantees and the lack of transparency. The project for the Port of Rijeka is the best example that words are not followed by deeds, despite declared interest on both sides of the deal. The overall picture is illustrated by *Figures 7 and 8*. Despite the recent jump in Chinese investments to Croatia, they started from a very low base and offer plenty of room for further improvement. There were only a handful of Croatian companies present in the Chinese market in 2016 (*Table 4*). As already stated above, the biggest potential lies in tourism, the food and beverages processing industry, IT and infrastructure.

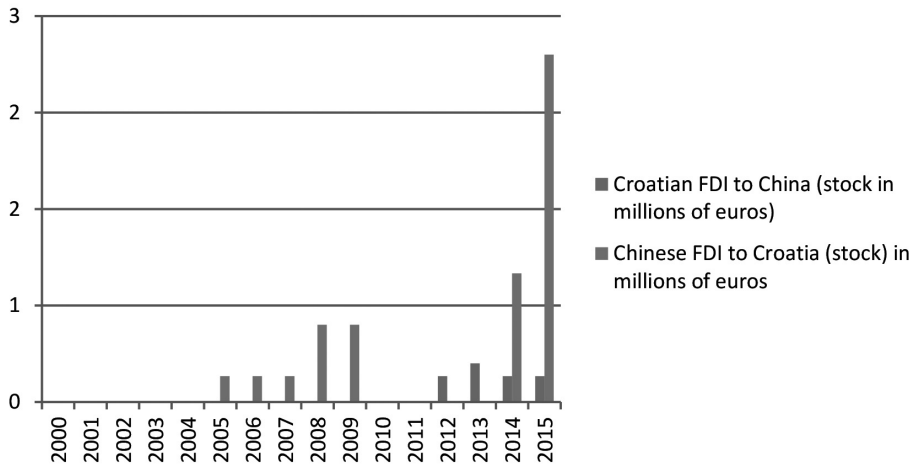
Finally, when considering financial flows other than FDI, there is also plenty of scope for capitalising on the potential for collaboration. China's credit mechanism of 10 billion USD earmarked for 16 CEE countries represents a good source of long-term finance. Nevertheless, the EU members of the China + 16 framework should push for a joint revision of the lending criteria, which continues to depend heavily on state guarantees. Apparently, there is an issue of incompatibility with the EU's competition policy framework. Last, but not the least important opportunity represents the potential of signing the bilateral currency swap agreement between the Croatian National Bank and the People's Bank of China (PBOC). Five members of the China + 16 framework can already tap into liquidity provided by the PBOC when necessary. Apart from Slovakia, Estonia, Lithuania and Latvia as eurozone members, Albania can also call upon the credit line in RMB when trade finance is scarce (Li, 2015). In order to diversify its foreign exchange reserves, a slight move towards holding 3-5% reserves denominated in RMB would be a welcome step for the Croatian National Bank, especially in the context of rising RMB internalisation.

## Conclusion

Sino-Croatian economic relations are nested into three hierarchical layers. Within the EU, Croatia's foreign economic policy vis-à-vis China can be categorised as that of a European Follower. There has been a very limited scope for diplomatic action and improvement of Sino-Croatian economic relations within the first layer of China-EU bilateral dialogue. The major obstacle is found in the lack of Croatia's foreign policy leverage in Brussels and the lack of political salience for EU-China issues among Croatian policy-makers. Croatian foreign economic policy-makers are best advised to stick with the principle of multilateralism in order to reap benefits emanating from the economy of scale. However, they should be aware that the EU's position on matters such as anti-dumping measures or investment disputes is the result of diverse cross-country and cross-sectoral interests. This requires special attention to the structure of the Croatian economy and the need for modelling scenarios of how China's 'market economy status' would impact key Croatian macro-economic variables.

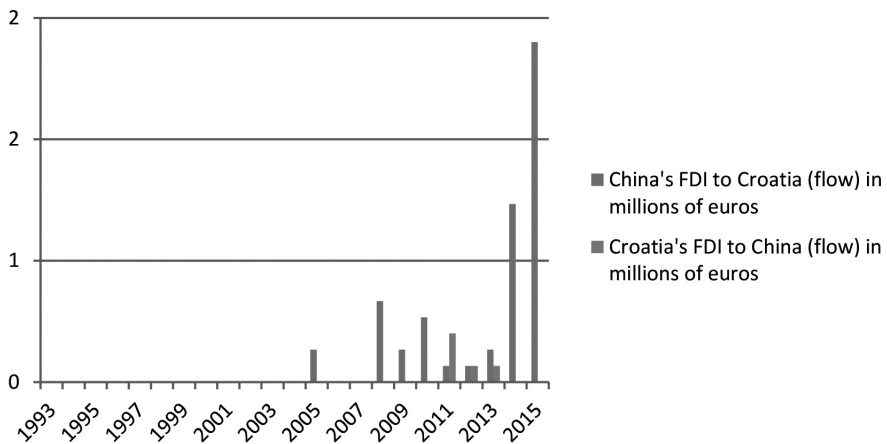
As opposed to the first layer, the China + 16 framework and bilateral relations between the PRC and the Republic of Croatia offer the opportunity for more agency on the part of Croatian policy-makers. The strategy of specialisation in the arena deemed as a priority provides every small state, keen on exploiting its comparative advantage, with a useful strategic tool. The functional distribution of tasks within the China + 16 where Croatia's neighbours and partners have decided to host various institutional offshoots and coordinative bodies serves as a stark contrast to Croatia's aloofness and passivity. Coordination and specialisation in the domain of tourism would be a welcome step forward. Other important steps would include an im-

**Figure 7.**



Source: Croatian National Bank

**Figure 8.**



Source: Croatian National Bank

proved coordination and exchange of information with CEE partners with the goal of lowering transaction costs and entry barriers for exporters to China. The coordination could span joint public and private initiatives in various sectors. Therefore,

**Table 4.**

<b>Registered Croatian companies in China</b>
TELEGRA d.o.o.
Jiali Tema Electric Manufacturing Group Co., Ltd. (joint venture)
Uniline
TBEA Končar (Shenyang) Instrument Transformers Co. Ltd. (joint venture)
Podravka d.d.
Badel
<b>Registered Chinese companies in Croatia</b>
Huawei Technologies Co. Ltd.
ZTE
LENOVO Technology b.v.
Asia d.o.o.

Source: personal correspondence with Mr. Ozren Baković

Croatian economic diplomacy should leverage renewed Chinese interest in CEE countries to the benefit of Croatia's economy and the economies of its neighbours. Finally, bilateral economic relations between Zagreb and Beijing could be put on an even better footing with enhanced trade and financial cooperation. The signing of a bilateral currency swap agreement and the sealing of several high-profile infrastructure projects would be a clear signal that both sides are highly committed to the type of cooperation that implies mutual benefits.

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**Eurostat** – data on CEE countries trade with the PRC

**Mr. Ozren Baković** – data on registered Croatian and Chinese companies in both countries

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