

# AN INVESTIGATION INTO THE ROLE OF INSTITUTIONS IN THE CHINA – VISEGRÁD 4 ECONOMIC COOPERATION

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## Abstract

With a new globalized face, the People's Republic of China brings several possibilities when it comes to transnational cooperation. Rapid economic development in the country, turned China into a significant player in the global market. Initiatives like the new Belt and Road projects, or the 17+1 cooperation platform, proposes significant alternatives for countries. After the launch of the BRI in 2013, a wider framework regarding international cooperation was created for China, which puts their Asian, African, and European relations to a new perspective. As a result of the 17+1 platform a major attention has been paid by Central Eastern European states towards Chinese initiatives, as a result of their strategic goal to reduce dependency on other European member countries, and to promote economic development. As both the CEE region and the 17+1 platform as well would be too broad to properly investigate, this master thesis will focus on a sub-unit of the region, the Visegrád 4. The group of Visegrád represents a major unit in the region, with relatively developed economic, social, and political environment. However, there is a massive economic gap between V4 countries and other Western European states. The main goal for them is to elevate to the same level. After the collapse of the Soviet Union these countries have formed a regional union to cooperatively tackle cross-national issues. A group was form on cultural, and historical heritage, similar social norms, and goals. Their economy is highly dependent on other European countries, and the governments are looking for alternatives to reduce dependency. The V4 countries are actively seeking economic partners outside of Europe, by cooperating with Russia, the US, or China. Foreign policy strategy of the V4 countries suggest, that the new Chinese initiatives are the most attractive option for them, and they dedicate significant amount of resources to deal with the PRC. When the unit of the V4 dedicates themselves to a mutual problem, they stand firm on a multilateral level to solve it; just like they all stood up against the European Union and their Migration Quota. As this example suggests, the V4 is becoming distant from the EU, and must seek further international partners. In an anarchic international environment, the role of institutions must be investigated, as they regulate the framework and influence economic development. Therefore, this paper will investigate the influence institutions have in the economic cooperation between the V4 and China.

*Keywords: China – Europe cooperation, Visegrad 4, CEE, 17+1 platform, BRI, Institutions*

## Table of Contents

<b>1</b>	<b>Introduction.....</b>	<b>4</b>
1.1	<i>Chinese Motivation .....</i>	5
1.2	<i>CEE Motivation .....</i>	7
1.3	<i>Introducing the Visegrád 4.....</i>	7
1.4	<i>The Significance of V4 Within the 17+1 Platform.....</i>	8
1.5	<i>The Presence of Institutions.....</i>	9
1.6	<i>Problem Formulation.....</i>	9
<b>2</b>	<b>Literature Review.....</b>	<b>10</b>
2.1	<i>Scholars' Research.....</i>	10
2.2	<i>The Visegrád 4.....</i>	14
2.3	<i>Institutions and Economic Development .....</i>	14
2.4	<i>Limitations .....</i>	17
<b>3</b>	<b>Methodology.....</b>	<b>17</b>
3.1	<i>Choice of Theory.....</i>	18
3.2	<i>Choice of Data .....</i>	19
3.3	<i>Method.....</i>	19
3.4	<i>Research Design.....</i>	20
3.5	<i>Data Limitations .....</i>	21
<b>4</b>	<b>Theoretical Content.....</b>	<b>21</b>
4.1	<i>Neoliberal Institutionalism.....</i>	22
4.2	<i>Douglass North's Institutions, Institutional Change, Economic Performance .....</i>	23
4.2.1	<i>Assumptions and Analytical Framework of Douglass North .....</i>	26
4.3	<i>Limitations and Applicability of the Theories .....</i>	29
<b>5</b>	<b>Analysis.....</b>	<b>31</b>
5.1	<i>The V4 Countries' Foreign Policy Towards China.....</i>	31
5.2	<i>China's Foreign Policy Towards the V4 Group.....</i>	31
5.3	<i>China's institutional consideration for the 17+1 platform.....</i>	32
5.4	<i>China and the Visegrad Group economic cooperation .....</i>	34
5.5	<i>Czech Republic.....</i>	35
5.5.1	<i>Political Level.....</i>	35
5.5.2	<i>Economic Level.....</i>	37
5.5.3	<i>Social level.....</i>	40
5.6	<i>Hungary.....</i>	41
5.6.1	<i>Political Level.....</i>	41
5.6.2	<i>Economic level .....</i>	43
5.6.3	<i>Social Level .....</i>	48

5.7	<i>Poland</i> .....	49
5.7.1	Political Level.....	49
5.7.2	Economic Level.....	50
5.7.3	Social Level.....	53
5.8	<i>Slovakia</i> .....	54
5.8.1	Political Level.....	54
5.8.2	Economic Level.....	55
5.8.3	Social Level.....	56
5.9	<i>Similarities and Differences of the the V4 Countries</i> .....	57
6	<b>Conclusion</b> .....	58
7	<b>References</b> .....	60
8	<b>Appendix</b> .....	70
8.1	<i>Appendix 1</i> .....	70
8.2	<i>Appendix 2</i> .....	70
8.3	<i>Appendix 3</i> .....	71
8.4	<i>Appendix 4</i> .....	71
8.5	<i>Appendix 5</i> .....	72
8.6	<i>Appendix 6</i> .....	72
8.7	<i>Appendix 7</i> .....	73
8.8	<i>Appendix 8</i> .....	73
8.9	<i>Appendix 9</i> .....	74
8.10	<i>Appendix 10</i> .....	74
8.11	<i>Appendix 11</i> .....	75
8.12	<i>Appendix 12</i> .....	75
8.13	<i>Appendix 13</i> .....	76

# 1 Introduction

China has evolved enormously, and experienced significant changes over the last 40 years. The Asian giant did not only achieve significant power domestically but on an international level as well. The PRC's significance in international relations have been increasing ever since the opening up policy in 1979. Joining ASEAN (Association of Southeast Asian Nations) in 1991 was a sign of transnational power on a domestic level and amongst Asian territories. By joining AESAN, China has strengthened its position in political, economic and social cooperation all over the Southeast Asia region (ASEAN, 2019). Internationally, the breakthrough for China came in 2001 as a consequence of long negotiations, the country got accepted in WTO (World Trade Organization). The significance of being a WTO country for China is unquestionable, as it brings several economic and political opportunities for the country. WTO serves as a "middle man" for China for trade negotiations, resolving issues with other members, and an opportunity to provide help for developing countries (WTO, 2019).

China did not only take the advantages of trade negotiations effectively but also started to support growth in under developed regions by promoting social and economic development. In 2000, as their first sign of aiding under developed regions, China initiated a multilateral agenda with African countries; therefore, the Forum on Africa – China Cooperation was launched. By virtue of accomplishments in Africa, in 2012 China turned to another region and set up the China – CEE platform in Warsaw (Information Office of the State Council, 2014). China – Central Eastern Europe (CEE) platform, or 17+1 platform includes 17 countries from the region plus China. Out of the 17 countries 12 of them are members of the European Union, (Bulgaria, Croatia, the Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia). While the other 5 members are not yet a part of the EU, (Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Serbia). According to the People's Republic of China's (PRC's) Ministry of Foreign Affairs, the idea behind the 17+1 is to promote development in the Central Eastern European region, to strengthen the ties between China and Europe, and to improve trade, investment relations (Zhifei, 2018) (Sabina Carli, 2019).

The 17+1 platform is part of China's massive foreign strategy, the Belt and Road Initiative (BRI) which can redefine international relations between the Asian giant, Europe, Africa, and Asia. Even though the 17+1 platform was established in 2012, and was introduced as an individual framework, ever since the launch of the BRI in 2013, it can be considered as part of

a larger plan. China has launched BRI in order to resurrect the ancient trading route, Silk Road (Li, 2019). BRI builds up from two main parts, two belts. The first one, a land belt, follows the ancient route of the Silk Road, and goes through West-Asia, Central-Asia, the Middle East, and Europe. While the second belt, a maritime belt, connects China with Africa, and leads all the way up the Suez Channel into the Mediterranean Sea. BRI includes a complex system of railroads, highways, ports, oil and gas pipes; and covers around 65 % of the world population, with a staggering one third of the world's GDP. Chinese scholars and media define BRI as “business of the century”, and a project that revives an ancient trading route which, for thousands of years, has been a symbol of peace, cooperation and development (Huang, 2018) (Li, 2019). Due to the BRI and foreign policy strategy the CEE countries attract a massive attention from China (Jakobowski, 2018).

### **1.1 Chinese Motivation**

Over the last 40 years the PRC has experienced a rapid economic growth due to their new approach on government policies. This rapid economic growth happened in such a massive volume of an annual average of 9,72%, that China has become the second largest economy in the world, and it is just a matter of time until they replace the first one. However, in order to do that, further developments are required from political, economic and social perspectives (Lau, 2015). During the early period of 2000's, China became the largest FDI receiving market. By the end of the decade China became the largest exporter in the world, providing products all across the globe, ranking in a key position for almost all other states. While in 2009, the most import for several different states arrived from China, making them the world's largest exporter. As the growth of the export suggests, the PRC did not have immediate impact of the 2008 financial crisis but the vulnerability, and volatility of their economic growth slowly started to surface. A slow annual decrease of economic growth turned into an annual 6,7% in 2017, while became the worst by 2019 with an annual rate of 6,1% (Jakobowski, 2018). Researches argue, that by the end of 2020, China will yet again end up having a decreased volume of growth, with their economic development further slowing down. However, considering the numbers, the volume of economic growth is still noteworthy, and the current volume is still not significantly decreased compared to the previous 9,72% annual growth, regardless of the PRC's economic slowdown (Sabina Carli, 2019). Nevertheless, numbers still show a steady economic growth from year to year the economic slowdown unquestionably is in process. In relation to this slowdown China introduced a massive investment program to try to tackle the issue.

The PRC acted accordingly to requirements and allocated an enormous 44% of the country's GDP on investment programs (Jakobowski, 2018) (Sabina Carli, 2019). Within the context of this vast investment program, significant business sectors met new, revitalized government policies, which aimed to develop an efficient business strategy to promote growth, by expanding businesses, and encouraging consumption. However, the new investment policies will not be able to singlehandedly solve the question of economic slowdown. Therefore, other measures have been taken by the Xi Jinping administration to promote economic growth by new initiatives. The already introduced BRI is one of the many, recently revised strategic ideas. As part of their foreign policies, the PRC is aiming to reach new markets to overcome the issues of economic slowdown by promoting international economic cooperation. A country with so high dependency on export and investment must aim for market expansion, for which, the best way is to engage on a transnational level (Barbosa, 2018). In order to overcome the issue of economic slowdown, international operations, and new markets are key priorities for the PRC, as one the most significant matter is industrial overcapacity. The level of industrial overcapacity has exceeded a staggering 30% in sectors like steel, aluminum, iron, solar panel or even glass cement. The over productivity in these sectors are strongly linked with a high competition of the market induced by government funded low interest rate loans, and government investments in manufacturing. The production cost has considerably decreased which fundamentally leads to increased output (Sabina Carli Faris Kocan Nina Pejic, 2019). The 17+1 platform can provide an alternative solution for market expansion for China, as the CEE countries have the potential to further engage in an economic cooperation.

Furthermore, the CEE region offers other strategic advantages besides a new consumer, and capital market. Geographical location is one of those advantages, as the Western European markets are located within a very short distance from any of the member states of the 17+1. Due to this location the transportation time can be significantly reduced. In a case if Huawei manufactures or even assembles in one of the CEE countries, new products can reach German or British markets in relatively short time. Furthermore, manufacturing in an EU member state of the 17+1, under EU regulations, the new products can be labeled as "Made in EU" which draws more attraction in the new markets. The production costs in these countries are relatively larger than Chinese standards but still not as high as western European standards. This new production cost with the decreased price, and time for transportation will generate more profit. Moreover, engaging in these countries means engaging with European institutions, following

EU regulations, providing development throughout the region which all adds up to a positive image of China (Sabina Carli, 2019).

## **1.2 CEE Motivation**

Considering the motivation for cooperation within the 17+1 platform for the CEE countries, several different aspects can be mentioned. Aim for close economic, social, cultural relations in order to acquire an acquaintance with the second largest economy in the world, thus decreasing dependency on other EU member states. Improving infrastructure in the region is also seen as a key factor for cooperation due to lack of investment from EU institutions. Mainly, the 17+1 platform serves as a forum to tighten relationship with China. As it was mentioned earlier, these countries act and decide individually, therefore the motives vary. While some countries have minor goals and strategy, others have massive plans. For instance, Hungary and the Orban administration introduced the “Eastern Policy” in 2012. The core idea was that the country must look for the east in order to strengthen economic partnership with countries like Russia or China. Hungary believed that, cooperation with China can boost their economic system, which then will be less dependent on Western Europe and the European Union (Agnes Szunomar, 2017). Both the Chinese and CEE motivations for cooperation will be further discussed in the literature review section as there are multiple opinions about them, and most of the are rather relevant in understanding the problem.

## **1.3 Introducing the Visegrád 4**

In order to lead this paper towards a comprehensive analysis, the focus must be narrowed down. The size, complexity of cultural backgrounds, of the CEE region is still too board, and it would be nearly impossible to analyze each and every country within one master thesis. Therefore, this thesis will put its focus on the most significant group of the region which builds up from 4 different countries. The Czech Republic, Hungary, Poland, and Slovakia add up to a group called the Visegrád 4 (V4). After the collapse of the Soviet Union and the decline of communism in Central Europe, in 1991, a meeting took place between the Czechoslovak (formally one country, now Czech Republic and Slovakia), Hungarian, and Polish prime minister in Visegrád, Hungary. Due to the similarity in culture and history, they formed an alliance which was motivated by 4 key factors. First, to completely eradicate communism from Central Europe. Second, to overcome the historical hatreds between Central European countries and support peace in the region. Third, to promote cooperation as it will lead to common goals,



such as a European integration. While the last factor was to promote political transformation (The Visegrad Group, 2019). As of today, the V4 has gained its importance, and represents a significant unit the CEE region.

#### **1.4 The Significance of V4 Within the 17+1 Platform**

In the CEE region the V4 countries represent the most developed states and the highest economic stability. According to different studies, around 75% of trade between China and the CEE region occurs at this sub-region. (Turcsanyi, 2014) Moreover, within the 17+1 platform the V4 countries attract the most investment from China. (Bieliński, et al., 2019) According to a survey by the “European Attractiveness”, the Central Eastern Europe region represents the fourth most attractive region in the world for investors; a region where the V4 countries are the most dominant. (Gontkovicova, 2016) The relatively powerful economy in the region started to build up from a significant amount of foreign direct investment before the financial crisis in 2008. (Fifekova & Nemcova, 2015) (Simionescu, et al., 2017). However, according to other studies, since joining the EU, the V4 countries have lost some advantages in cooperating with China due to EU regulations. (Raisova, 2007) Ever since being involved in the EU, the institutional environment has changed for the V4 countries. In comparison, the previous national institutional environment shifted to a EU centric institutional environment. All the transnational trade is supervised and regulated by EU institutions, such as the European Commission or the European Parliament. Therefore, the presence of transnational institutions became a significant part of the bilateral trade agreements. (Treaty of Lisabona, 2007) Foreign policy and strategy of the V4 countries varies, as their economic structure, and motivation towards cooperation with other countries are different. National interests always play a key significance. The earlier presented EU institutional framework highly determines trade agreements, but bilaterally several EU members have set up transnational trade agreements with countries outside the EU to promote economic cooperation, and development. These agreements are also influenced by such an institutional framework which is not necessarily regulated by the EU (Fojtikova, et al., 2017). According to researchers, monetary operations of EU member states with a third country are first supervised within EU institutional framework. Yet, individually these EU member states have set up several fiscal policies, trade strategies and signed transnational agreements with those “outside the EU” countries (Fojtikova, et al., 2017).

In a case of China, V4 countries represent an active member within the BRI framework, and offers the opportunity to strengthen their position in Europe. Beijing has proposed three ideas to further develop cooperation with the V4 countries both individually and as a unit as well. First of all, China believes that the V4 countries can serve as a perfect middleman in their European integration process due to these countries previously mentioned advantages. Furthermore, believes that a significant increase of soft power can be achieved through friendly cooperation. And as last the leading role of these countries under the 17+1 platform. (Wang, 2018).

### **1.5 The Presence of Institutions**

As the earlier paragraphs have already shown, there are several institutions that are supervising, and guiding the cooperation between China and the V4 countries. Recent years show that due to a massive level of globalization, an increasing number of transnational agreements, the role of international institutions became more significant than ever before. (MacKenzie, 2010) (Reinalda, 2009) Several researchers have come up with a definition to understand institutions. According to Ostrom, and Mearsheimer, international institutions can be understood as a “*sets of rules*” created to control international cooperation, and competition. While according to Keohane and North, institutions are guidelines on international cooperation, but they divide institutions to a formal, and informal subcategory and emphasize the role of organizations in the proper functioning of international institutions. (which will be later explained in the theory section). (Ostrom, 1990) (Mearsheimer, 1994-1995) (Keohane, 1984) (North, 1990) According to Mearshimer, who goes completely against Keohane and against neoliberal institutionalism, he believes that even though neoliberal and neorealist institutionalism are different they both agree on the significant role of institutions from an economic perspective. (Mearsheimer, 1994-1995) After, examining the possibilities, and current relations between the V4 countries and China, it can be understood that the institutional environment plays a massive part in achieving economic development.

### **1.6 Problem Formulation**

To be efficient, and to acknowledge successful operations within the 17+1 framework, numerous policies, and strategies have been introduced with clear goals. Furthermore, to promote transnational cooperation, several institutions have been founded which are operating cooperatively with previous institutions to help achieve those goals. Moreover, alongside

formal institutions the presence and significance of informal institutions must be understood and analyzed. As it was presented, the size and complexity of the 17+1 platform would not lead to a comprehensive analysis, therefore, this master thesis will concentrate on the V4 sub level of the 17+1 platform. Since in the region, these countries have a higher commitment towards China which makes them more willing to cooperate, and are highly dependent on an institutional environment; the economic development is highly dependent on the efficiency of the institutions. After analyzing the possibilities for a problem formulation, this master thesis will formulate the problem question as: ***“How do formal- and informal institutions influence the economic cooperation between the Visegrád 4 and China under the 17+1 platform?”***

## **2 Literature Review**

In this section this master thesis will provide an academic background to emphasize the relevancy of the problem formulation. Ideas, assumption, and theories of different researchers will be introduced in the field of China – 17+1 platform, institutionalism, V4, and limitation of the research.

### **2.1 Scholars’ Research**

In 2013 the inauguration of the BRI has launched a rapid interest amongst researchers towards the new initiatives. The newly introduced Chinese initiative has provided a platform for cooperation for the CEE countries with the PRC. The core for the 17+1 platform is a mutual development and cooperation in terms of politics, economics and social improvement. According to different researchers, the perception of China by the CEE member states represent a high significance in determining the level of cooperation. Based on the findings by Oehler-Şincai, the massive development achievements by China is considered as a threat by developed countries, while for developing countries it is perceived as an opportunity for development and to decrease economic dependency on the EU (Oehler-Şincai, 2018). Other researchers argue that the political history of the CEE region, the fact that all the European members of the 17+1 was highly influenced by the ideologies of the Soviet Union, and was part of the socialist community, highly add up to their participation in the framework (Vangeli, 2017) (Kowalski, 2016).

Several 17+1 transnational conferences have been established between China and the CEE countries, therefore, the concept of the 17+1 platform can be understood as a multilateral context that promotes a sub-unit of Europe to cooperate with China. Yet, many scholars believe that the 17+1 is a China dominated concept, where the Asian giant can develop bilateral relations with certain member states (Cacrlı, et al., 2019). Nevertheless, the fundamental idea is to promote cooperation by transnational relations supported by the regular 17+1 official meetings, the accomplishment of the cooperation is predominantly happening on a bilateral level by individual arrangements between China and a member of the 17+1 (Stanzel, et al., 2017) (Jakobowski, 2018). Even though the relationship could be considered on a multilateral level, researchers argued that the European members lack a common, and also a national foreign policy strategy towards China (Cacrlı, et al., 2019). In their China – CEE cooperation related study, the researchers Cacrlı, Kocan and Pejic examined the different foreign policy strategies of the 17+1 at both multilateral and bilateral level, by applying the theoretical analysis of Dr. Vlado Benko. The essential ideologies of foreign policy analysis focuses of 3 different factors of foreign policy, values, instruments, and goals. The results showed a massive absence of official foreign policy strategy towards China. Besides Hungary's Eastern Opening Policy, which is not directly concentrated around China but countries from the East, only 5 countries of the 17+1 platform had a clear foreign policy strategy towards China (Bosnia and Hercegovina, Croatia, the Czech Republic, Poland, and Slovenia) (Cacrlı, et al., 2019). A foreign policy strategy can be understood as an essential tool of a political institutions.

In order to access Western European market, the CEE region embodies a significant milestone for China. (Stanzel, 2016) By improving infrastructure in the region, China will initiate a way towards physical connectedness and economic integration with Europe. (Dragan, 2015). According to researchers there are numerous motives for China to accomplish success within the 17+1 framework. The different motivations vary from applying their policy on the CEE region, creating a positive image of China by providing development, to access European markets for both distribution and manufacturing, and to further strengthen economic exchange. (Oehler-Şincai, 2016) (Cacrlı, et al., 2019) Even if the CEE countries can be considered as geographically connected, they contribute differently to the regional economic distribution of power. Therefore, China operates differently which each country from the region. According to monetary studies, CEE countries which are not member of the EU attract more Chinese Foreign Direct Investments than those member states who have easier access to EU funds (Bieliński, et al., 2019). Assuming that the dependence on foreign investment and foreign trade

results in the need for new collaborations and new markets; then Cacarli's hypotheses which implies that, by using its own foreign investments and loans, China secures new markets can be considered valid (Cacarli, et al., 2019). As part of their FDI strategy, numbers show China's preferences to invest in infrastructure projects. Infrastructure projects have a win-win ending for both China and the CEE countries. As on one hand, by developing their infrastructure, CEE countries are able to boost their economy. While on the other hand, investing in infrastructure projects, China aims for both short and long-term effects. Scholars argue, that in the short term, China boosts its export of construction, and manufacturing related materials and goods (steel, concrete and other products that are part of the overcapacity issue); and on the long term, by boosting connectivity China improves its trade relations (Cacarli, et al., 2019) (Dragan, 2015).

Essentially, the massive gap in the development of infrastructure between East and West Europe is one of the main economic motivations for the CEE countries for a tighter cooperation with China. OECD studies show that in Balkan countries, especially due to the lack of investment in Yugoslavia from both before and after the war, the average infrastructure development in the region is about 50% lower than the EU average, ranging from about 30% lower in Serbia to nearly 70% lower in Albania (OECD, 2019). Moreover, underdeveloped infrastructure is a significant problem also for the EU member countries, especially amongst the "new members" (which are mostly Central, and Eastern Europeans countries). For instance, according to a study from 2017, infrastructure gap between EU states already represents a serious issue, which may grow even larger after the 2014-2020 EU funds expire (Cacarli, et al., 2019). However, countries which are both member of 17+1 platform and the EU as well, might have difficulties in synchronizing their policies towards Chinese investments, due to EU standards and regulations. When it's a large foreign investment project, China requires state guarantees for their investment from the receiving partner states, but according to some experts these guarantees can also be opposing EU regulations on investment aid, preferential treatment of investors or other irregularities (Stanzel, 2016). This argument can explain China's interest in the Western Balkans (especially Serbia), since these countries are not yet members of the EU, thus, do not have to follow EU regulations. However, at the Sofia Summit in 2018, the 17+1 platform was presented as a part of EU-China relations, which creates a controversy with the above-mentioned (Turcsanyi, 2018). Moreover, this controversy was already addressed as early as 2014 by the Belgrade Guidelines. It was proposed that all 11 EU members (now 12) would act accordingly to EU legislations, regulations and policies (Ministry of Foreign Affairs of the PRC, 2014).

According to Svetličič's study, both the EU-China Connectivity Platform (2015) and the Riga Declaration (2016) were aimed to emphasize the different characteristics between CEE – China and EU – China relations (Svetličič, 2019). Other studies suggest that the problem is not solely about the quantity of infrastructure investment, but also about quality. According to the World Economic Forum's from 2017 and 2018, their Competitiveness Report points out that in terms of transport infrastructure quality, Western Balkans countries rank 98<sup>th</sup> out of 137, and the EU members among the 17+1 rank between 44<sup>th</sup> (Estonia) to 102<sup>nd</sup> (Romania), with an average rank of 66<sup>th</sup> place. (World Economic Forum, 2019) Over the past 20 years, more than 210 billion Euros was spent on transport infrastructure amongst the EU members of the 17+1 group. (PWC, 2017) As a result, it can be concluded that the countries of the region have been looking for additional sources of financial support, and China, due to its BRI program fits perfectly with the region's infrastructure needs.

The 17+1 platform represents a series of opportunities and challenges for both the participants and other regional actors as well. It must be mentioned, that before the establishment of the 17+1 platform, China only conducted strategic partnership with Hungary, Serbia and Poland (Ping & Zuokui, 2017). The same research shows that, the multilateral framework of the 17+1 platform, opened the path to bilateral relations between China and the Western Balkans (Montenegro, BiH, Serbia, Macedonia) and between China and Baltic states (Estonia, Latvia, Lithuania) (Cacrlı, et al., 2019) (Dragan, 2015). However, other researchers and EU institution leaders criticize the Chinese engagement in Central and Eastern European countries due to the PRC's motivation to increase its regional influence. Furthermore, criticize other EU member states which started have closer ties with China. For instance, the Hungarian prime minister, Viktor Orban, has publicly mentioned the closer economic ties with Beijing as an alternative for the cooperation with the EU or other EU member states "Central Europe needs capital to build new roads and pipelines. If the EU is unable to provide enough capital, we will just collect it in China" (Orban, 2018). Yet another example characterized by experts is the "responsibility towards China as an investor". A few years ago, another opposing situation happened, when the EU showed its incapability to issue a common declaration to support the South China Sea Arbitral Tribunal Ruling. Croatia, Hungary and Greece opposed the common idea of the European Council, as Hungary has the Budapest-Belgrade Railway project underway, while Greece was negotiating the investment and acquisition of the Port of Piraeus (Cacrlı, et al., 2019). However, other scholars believe that the 17+1 platform does not pose a threat to the existing multilateral cooperation in Europe, because the CEE is not economically

dependent on China, and as long as the EU continues to offer attractive prospect to help countries to develop, China plays just a marginal role (Jakobowski & Kaczmarek, 2017). Nevertheless, scholars believe that China takes the EU's concerns about its implication in the CEE countries seriously and responds with actions (Jakobowski, 2018). For instance, China modified its approach and consulted the European Commission and CEE about its proposals in advance of the summit in Bucharest, which also resulted in Bucharest guidelines that highlights that any China-CEE cooperation should be in accordance with the China-EU strategic partnership (Caculi, et al., 2019).

## **2.2 The Visegrád 4**

The sub-region as a whole, stands for the 5<sup>th</sup> strongest economic power in Europe and the V4 members are considered the strongest economic powers among the newest EU member states (Simionescu, 2017). The developed economy is primarily due to the acquired FDI before 2008 (Nemcova, 2015). Furthermore, comes from the advantageous economic environment for investors and a willingness for transnational cooperation (Simionescu, et al., 2017). Based on the findings by Radu, economic development in the V4 region was highly influenced between 1990 and 2010 by formal institutions in relation to the collapse of communism. Formal institutions as in, political stability, and freedom (Radu, 2015). Even though V4 represent a strong economic unit in the CEE region, the higher objective would be achieving a steady economic growth and to step up a level to Western European standards (Stanzel, 2016) (Stanzel, et al., 2017). Researchers highlight the vital position of China in promoting economic development in the CEE region through the 17+1 platform, hereby assigning a crucial role for the PRC in the development of the V4 region as well (Szunomar, 2014). V4 countries are keen to further engage in economic cooperation with China, however, statistics of recent years outline a serious trade deficit due to their capabilities (Fojtikova, 2017).

## **2.3 Institutions and Economic Development**

In order to be able to give an explanation on the role of institutions in economic development, the definition of institutions must be clarified; what institutions are, what they do, and how do they operate. Based on Keohane's theory, institutions are, "*persistent and connected sets of rules (formal and informal) that prescribe behavioral roles, constrain activity, and shape expectations*" (Keohane, 1984). Therefore, we can see from his idea, that institutions are a concept in which, rules about different decision-making processes are set; it includes formal

institutions such as trade agreements, and also informal, such as cultural heritage. According to North, institutions are manmade frameworks that supervise human interaction by providing norms, incentives and disincentives, to act in a certain way (Douglass C. North, 2003). So, it can be considered as, institutions provide a moral education function, which is imperative for well-functioning cooperation. Mearsheimer argued for an opposite idea on institutions in his book, the false promise of international institutions. He goes against the importance of institutions assigned by neoliberals, and approaches from a nonrealistic way. He claimed, that institutions do not have significant influence in peace keeping, while he agreed on their role in economic cooperation (Mearsheimer, 1994-1995). Acemoglu and Robinson believes that institutions matter, and that it is imperative to understand how different institutions can be between across different nations. Institutions are influenced by several different aspects, such as monetary background, decision making process, and other cultural norms (Acemoglu, 2008). For instance, a good example could be North's take on explaining the adaption of the US constitution by Latin-American countries. After the cold war these countries attempted to apply the same constitution on their countries, however, regardless of the efficiency, and applicability the constitution brought to the states, in Latin America it failed.

Regardless of the agreement on the important role institutions play in economic development, researcher have different ideas on how exactly do they promote economic growth. Generally accepted fact, the correlation between the efficiency of institutions and various economic indicators but the why is different. Based on the findings by Acemoglu and Robinson, economic institutions are strongly linked with political leadership, and it is imperative to consider political forces when influencing institutional environment, as those political leadership has created them, operates them, and without their willingness the environment won't change (Acemoglu, 2008). Furthermore, they developed two sub categories for institutions, "*extractive*", and "*inclusive*". An extractive institution is governed by a small group of individuals trying to obtain as much influence as possible, while an inclusive institution contains a large number of individuals and drives towards a common goal. Economic development is considered as a result of how states approach these two different kinds of institutions (Acemoglu, 2012). Academics in the field of economics often argue, that institutions are created as a result of rational choice by individuals who are driven by selfish interests. The idea is of material gains through cooperation, while in reality leading to inequalities on a free market (Chang, 2007).



Nevertheless, along with other researchers, Chang claims that the free market is yet another institution governed by formal and informal limitations and policies, supervising activities of the participants (Chang, 2002). Furthermore, in their research from 2007, they divide the origin of institutions into two separate categories, claiming that institutions are either born on an *efficiency-driven* approach, or on an “*interest-driven*” approach. While the first category represents institutions that are created in accordance to a market failure and are aiming to promote economic development or common goal; the second category is for institutions that are driven to be esteemed by a private interest, based on an individual will instead of a general one (Chang, 2007). The most significant factor in promoting economic development by institution is to identify the possible threats for dominance and focus on general will and common goals.

Quality of institutions are considered as the most important factor by other researchers. According to Balamoune-Lutz, the level of economic development depends on the decision, and quality of institutions (Mina Balamoune-Lutz, 2006). A year later in a study, Balamoune draw up the conclusion with Ndikumana, that, an unquestionable responsibility is assigned with institutions in improving the quality of trade liberalization, and trade openness. As the higher the quality of the institution is, a higher quality of trade control it will have. Or from another perspective, if trade openness is on a high level, the same high-level institutions will be launched. institutions play an important role in enhancing the effectiveness of trade liberalization because if trade openness reaches higher levels, better institutions appear to enhance the growth effects of openness (Balamoune-Lutz, 2007).

Institutions have several impacts on economic growth, according to Lewer and Van Den Berg states that export capital goods, and import consumer goods develop slower than the ones exporting consumer goods. Therefore, institutions must guide the expansion, and liberalization of trade and help it develop in to economic growth (Lewer J. & Van den Berg, 2003). concluded that countries that import capital good and export consumer good grow faster than those that export capital goods (Lewer & Van den Berg, 2003). This idea suggests a key role of institutions in economic development. Other researcher debates about the short- and long-term efficiency of institutions. Based on the findings by Dollar and Kraay there is a mutual effect of trade combined with institutions on the long run but on the short trade has a larger impact. In their idea, institutions need time to evolve and make a significant impact in economic development, nevertheless, creating and sustaining high quality institutions are imperative in state operations

to transmit trade relations into long term economic growth (Dollar, 2003). Furthermore, according to the previously mentioned duo of Ndikumana and Balamoune-Lutz, a proper economic control combined with high-quality institutional environment, proper strategies regarding decision are created to further promote economic development. A quality institutional environment reduces economic instability when a market failure occurs. Moreover, they believe that regardless of the lack of short-term effects, on the long run economic growth can only be achieved by a certain institutional environment (Balamoune-Lutz, 2007).

## **2.4 Limitations**

Several limitations can be found regarding the role of institutions in the economic cooperation between China and the V4 countries under the 17+1 platform. First of all, researchers in the field of IPE, IR, or even macroeconomics focus mostly on the asymmetric trade relation between the EU and China. Most Western scholars investigate dependency, and the dominant position of the PRC. A great proportion of the studies focuses on China and the EU in general, even if they narrow it down it is mostly Western Europe or 17+1 in general. There are just a few studies which are narrowing even the 17+1 one, let alone the V4. Only a small percentage of the sources available were investigating bilateral relations between the V4 countries individually. These are in their native language, Polish, Slovakian, Czech or Hungarian, from which, due to lack of knowledge, only the Hungarian was available.

However, there are some reports focusing on sub regional level of the EU, highlighting importance of the 17+1 platform in influencing EU-China relations but a sole focus on the V4 and China relation is not available. This master thesis tries to fill the gap on the subject, by introducing a wide-ranging analysis of the V4 – China economic cooperation under the 17+1 platform, especially in understanding the role of international, and national institutions.

## **3 Methodology**

In order to be able to properly answer the problem question, this research has been conducted in a certain way. Therefore, in the upcoming paragraph, the chosen methods and the core methodology of the paper will be explained. First off, a chapter about the selection process of the theories, followed by the utilized data, after that by the methods of analysing, while a research design and a data limitations sub chapters come last.

### **3.1 Choice of Theory**

In the theory section of the methodology, the selection process of the used theories will be discussed. This paper will rely on two closely tied theories, which are strongly linked with the understanding of the role of formal-, and informal institutions in the economic cooperation between China and the Visegrad 4 under the 17+1 platform. First, neoliberal institutionalism by Robert O. Keohane, while the second one is a theory by Douglass North, the role of institutions in economic development. Neoliberal institutionalism is a commonly used International Relations theory which describes the role of international institutions in promoting cooperation. While the second theory, introduced by North, is strictly connected with neoliberal institutionalism and takes the role of institutions to an analytical level to understand their responsibility in economic development. First of all, when the topic research begun it was imperative to understand that there are certain political and economic institutions which are shaping the environment of the cooperation of the 17+1 platform, therefore, the cooperation between China and the V4. Looking into the topic, it was unquestionable, to understand the economic cooperation the role of institutions must be understood. Neoliberal institutionalism suggests, that in an anarchic international environment, transnational institutions are responsible to coordinate cooperation and to promote efficiency (Keohane, 1984). Considering the role of political, and economic institutions created the impression of something missing in understanding economic cooperation. During this period of the research I came across with North's work, which divided institutions to category of formal, and informal providing a different perspective (the next chapters will further distinguish the above-mentioned terms) (Douglass C. North, 2003).

After studying his work, it was rather simple to understand the significance he places on individual actors in an institutional environment, and the role of their private "informal institutions". Decisions of individuals are undeniably creating uncertainty in any form of cooperation, social customs, cultural behavior, different preferences, and motivations mount up to a critical factor that can harm even a flawlessly organized institutional environment. Moreover, according to North, in order for institutions to be able to tackle the issue of the everchanging and evolving nature of problems, they must evolve accordingly. In such a constantly changing, and volatile environment like the economic cooperation between China and the V4, this adaptiveness of the institutions must be considered (Douglass C. North, 2003).

Therefore, in order to be able to present a comprehensive analysis to the research question, North's theory seemed like the last link to provide the finest theoretical framework.

### **3.2 Choice of Data**

Sources chosen for this master thesis build up from both primary and secondary data. Primary sources can be considered as official statements such as reports from the EU, Visegrad 4, Central Eastern European institutions, Chinese white papers, bilateral agreements, and official state reports. Whereas, secondary sources are described as academic sources, for instance, scholars' researches and reports. Therefore, this thesis will rely on secondary sources as well, especially in the theory, and analysis section. For the theory sections, publications by Douglass North, Robert O. Keohane, and Stephan Nye will provide an empirical background. Furthermore, in order to achieve an extensive and detailed analyses, other secondary sources such as online articles, think-tank studies, reports by different organizations will guarantee additional data. The complexity of the role of institutions in the cooperation between China and the V4 countries requires the use of a massive variety of sources in order to be as objective as possible. Moreover, the more sources a research relies on, the broader the perspective will be which also promotes objectivity, and credibility. Both primary and secondary sources offer a variety of qualitative and quantitative data as well. It is essential that a research examines quantitative data, as numbers always guarantee objectivity. Nevertheless, it is imperative to acknowledge the size of the problem area, therefore it is unmanageable to collect all data available due to time, and page limitations. Another useful way for data collection would have been to conduct an interview with leaders of transnational institutions, V4 or Chinese policy makers, unfortunately due to the lack of connections it was not an option.

### **3.3 Method**

With the intention of understanding the role of institutions in the economic cooperation between China and the V4, a deductive approach have been used. A deductive approach means that based on available resources, the researcher makes assumption and draws the conclusion. This method suggests, that the individual assumptions of the researchers plays a key role. Therefore, it is significant to understand how a researcher structure their approach to understand a problem. Criticisms towards the use data is essential in order to stay as objective as possible. Throughout the research, qualitative and quantitative data have been combined to generate a

broader perspective. In addition, a participant observation can be considered. As the researcher is originally from one of the V4 countries and have visited all of them as well as China, a level of understanding about the culture, policy-making process, political, social, and economic environment is available. It can be concluded that the observation of the researcher plays a key role in understanding the problem. According to different authors, a researcher can obtain different believes, perspectives, inspirations, and motivations on any given subject (Denzin & Lincoln, 2011) (Lorrie Blair, 2016). Using this method allows the research to be able to gather a massive amount of information on the role of institutions in the economic cooperation between China and the V4 countries.

### **3.4 Research Design**

The first half of this master thesis builds on a descriptive approach, which means that theoretical assumptions will be considered to understand the role of institutions; this is highly dependent on qualitative data. While the second part of the thesis will rely on an analytical research method, based on both qualitative and quantitative data. The quantitative data comes into relevance to express the assumptions of qualitative data and try to answer the problem formulation. Furthermore, regardless of the use of theories, hypothesis, and data from other researchers, the writer's personal contribution of ideas can be found throughout the paper. Essentially, when a theory or any data provided by researchers are used, first it has been analysed, then there is an analysis part, where it is decided if there is any correlation with the topic. It can be considered as a descriptive approach as well, combined with a normative perspective; as the writer tries to improve the theory and fit it perfectly to the analysis. Since there will be both quantitative and qualitative data used in the master thesis in order to have a comprehensive understanding of the topic, an additional normative approach can be considered. Nonetheless, quantitative data will just provide a source to economic cooperation and to provide a general view. The numbers will just show a way to understand the problem, there will not be any further analysis on the variables. Therefore, there were no statistical program used in the analysis.

In the analysis section, first there is a short introduction on the cooperation between China and the V4 countries in general. Secondly, each V4 country individually gets a case study where the 3 level of analysis proposed by North will be investigated, political, economic, and social environment is examined to highlight the presence and importance of institutions. In each case study, the cooperation will be analysed bilaterally as the V4 countries tend to cooperate with

China individually. After the case studies there will be a section of the analysis which showcases the findings on the role of institutions in the V4 in general, furthermore a paragraph describing transnational institutions which are influencing the V4 as a whole, such as EU regulations or 17+1 institutions. Throughout all the analysis the ideas of neoliberal institutionalism and Douglass North will be considered, in order to be able to answer the problem question, how do formal-, and informal institutions influence the economic cooperation between China and the V4 under the 17+1 platform.

### **3.5 Data Limitations**

There are certain limitations to each research, this one is no exception of it. One significant difficulty is the lack of primary data, the absence of government statements. Both China and the V4 countries lack official statements on their cooperation under the 17+1 platform and on how the cooperation promote economic development. Furthermore, a great deal of the studies available, analyse both the V4, and the 17+1 platform under the framework of China-EU economic cooperation, so there weren't enough data which focuses on the chosen topic. Moreover, the language barrier comes into account as most of the statements by the V4 countries are written in their own language, and many of the Chinese sources are in Mandarin. Unfortunately, the original language sources could be analysed only in Hungarian, which made the Hungarian case study relatively longer.

One more significant limitation of the case studies is the government, and the policy maker statements, which must be examined critically. As there is no guarantee, that the outcome of an action will always be as the plan was about it. In other words, officials might not act accordingly to their promises. Though the frequency of official meetings between China and the V4 have rapidly increased ever since the launch of the 17+1 platform. It is still challenging to draw conclusion how the cooperation will evolve due to the lack of either bilateral or multilateral strategy between the sides. Therefore, it is hard to predict the volume of economic development.

## **4 Theoretical Content**

In this section the chosen theoretical framework will be introduced, that will guide the analysis section in order to answer the problem question. Alongside the previously introduced concepts in the literature review, there will be a deeper focus on two chosen theories. First of all, to begin from the neoliberal institutionalism by Keohane in combination with a more

narrowed approach, a second theory, the theory of institutions and the impact of institutions on economic performance by Douglass Cecil North. Both theories follow neoliberalist ideas but this paper will also consider a neorealist approach on institutions by Mearsheimer. Keohane, is an active political science professor, working at prestigious institutions and he has been associated with neoliberal institutionalism ever since his book “After Hegemony” has been published in 1984. While, North was a researcher in economic history and for his theory about institutions and economic performance, in 1993, he received a Nobel Memorial Prize in Economics.

#### **4.1 Neoliberal Institutionalism**

Cooperation between states, and other actors on a transnational level can be identified as a core idea of neoliberal institutionalism. In his first book about the theory, in 1984, Keohane claimed that transnational cooperation happens *„when states ‘adjust their behaviour to the actual or anticipated preferences of others’ so that ‘the policies actually followed by one government are regarded by its partners as facilitating realization of their own objectives’”* (Keohane, 1984). His ideas were that engaging in international cooperation states regulate their own behaviour to match other states demands. In reality it looks more like when two different states’ national interests meet, or there is at least correlation between them, international cooperation can be achieved. Furthermore, he believes, that one of the most significant difficulty of international cooperation is the nature of the global environment which is anarchic (Keohane, 1984). By an anarchic international environment, the author means the lack of world government to supervise transnational operations. However, the latest technological inventions, provided by rapid globalization, promote achievability of neoliberal institutionalist ideas.

Based on neoliberal institutionalism, states external involvement is always departed from a national interest, and actions taken by these states are based on a rational choice (Keohane, 1984). Cooperation can lead to advanced benefits in a global environment where actors are highly interdependent on one another’s actions. According to Keohane, and other institutionalists, the anarchic system, the lack of control of transnational cooperation is the key issue. Therefore, international institutions can supervise, promote, and sustain efficient transnational operations. A mutual consultation, increased flow of information within the boundaries of an international institutions create opportunities for cooperation. Institutions are responsible to supervise, and limit the environment by regulations in order to keep dominance out. A global hegemon in international operations creates dependency, and dependency leads

to situations where the dominant side pursues purely its own interests, leading to a decreased benefit for the dependent state. Therefore, dominance must be limited by institutions to achieve common goals and promote general will (Robinson James, 2008). A good real-life example for neoliberal institutionalism and the promotion of global cooperation and peace is the foreign policy of the US after the second world war. Where the States aimed to eliminate conflict instead of engaging in them.

Regardless of the many-faced approach on institutions and international cooperation by scholars. Even the two most edged side, neoliberals, and neorealists agree on the significance of institutions from an economic perspective. Regardless of the disagreement Mearsheimer showed in his book, “False promise of international institutions”, he agreed on the role of institutions in economic development (Mearsheimer, 1994-1995). Institutions promote cooperation about relative gains, and creates control over an anarchic system. By providing limitations, and information; participating states have a clear vision of possible gains and retaliation for breeching agreements. Furthermore, institutions provide a safe environment which coordinates interstate agreements for a mutual economic development. Therefore, over the next paragraphs a more economic development focus of institutions will be introduced by Douglass North.

#### **4.2 Douglass North’s Institutions, Institutional Change, Economic Performance**

North claims that, institutions are the guidelines of every interaction in a society, ” more *formally, are the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic. Institutional change shapes the way societies evolve through time*” (Douglass C. North, 1990). Essentially institutions can be understood as human concepts of regulating political, social, and economic interactions. The author divides institutions into two categories of formal and informal. Frameworks, rules, guidelines created by members of the society are formal institutions, whereas moral education, social norms, cultural heritage are informal institutions. Therefore, it can be understood, that institutions are either created, such as the European commission, or they can evolve to the environment over time, for instance, common law. Just like in the case of neoliberal institutionalism, North believes, that institutions provide regulations which determines the possible actions of participants, a common goal, and the volume of punishment for violating these restrictions (Douglass C. North, 1990). An easy to understand real life example of institutions is to compare it to basketball. The US created the



NBA, the National Basketball Association as an institute to regulate the country's professional basketball. A formal institution was born which decides about how the game is supposed to be played by written regulations and what are the punishments for breaching those limits. While the teams bring their informal institutions, team strategy, mentality, individual decision of players. Just like in other life situations, in basketball the rules set by a formal institution, in this case the NBA, can be violated in order to gain more benefits. For instance, the Detroit Pistons won several championships by an aggressive team strategy, aiming to injure other team's key players. They have violated rules but only in a matter that still brought more advantages than disadvantages. This decision to make is evaluated by a cost-benefit analysis, as the rules are clear for everyone, the question is, if it is worth it to violate them. When the punishment is less significant than the gains, the rules are often violated (Douglass C. North, 1990). Therefore, the Pistons as an organization of an institution, by analyzing the volume of punishment decided to follow down a different path which proved to be efficient for them.

North argues about the importance of separating institutions from organizations. *"Like institutions, organizations provide a structure to human interaction. Indeed, when we examine the costs that arise as a consequence of the institutional framework we see they are a result not only of that framework, but also of the organizations that have developed in consequence of that framework"* (Douglass C. North, 1990). To put it in a more understandable way, organizations can be separated from institutions, as organizations are members of a larger structure, the institutions. Organizations were created to be actors of a specific institution. According to North, the term organization involves players from a political, social, and economic level. Organizations on a political level are different political parties or local governments. While social organizations can be a school, church, or even a book club. Economic organizations contain companies or trade unions. When investigating the role of formal-, and informal institutions in the environment of economic performance, political or social change; it is imperative to analyze the collaboration between institutions and organizations. North claims to best understand institutions, actions of organization within a certain institutional environment must be investigated as well. Consequently, the analyses section with the case studies will emphasize this interconnectedness (Douglass C. North, 1990) (Wei Li, 2009). Understanding human behavior is essential to understand institutions based on North's assumptions. He claimed that, *"Institutions are a creation of human beings. They evolve and are altered by human beings; hence our theory must begin with the individual. At the same time, the constraints that institutions impose on individual choices are pervasive"*

(Douglass C. North, 1990). According to North, effectiveness of a certain institution or organization is highly determined by actors on an individual, micro level. Therefore, the significance of informal institutions of individual actors can be understood, as singular decisions come highly into account in shaping institutions. There is a massive interconnectedness to be spotted as institutions shape human interactions, by providing an environment for development of the society and outline future possibilities (Douglass C. North, 1990). In order to emphasize the significance of informal institutions, North focuses on the nature of the world as a fundamental basis for his theory. North believes there is a massive volume of uncertainty involved from all aspects in our world, there are no general principles or basic structures; and he calls this environment a “Non-Ergodic world” (North, 1990). Furthermore, the author claims the starting point of life for each individual is from uncertainty, and the way we understand our surrounding depends on two vital factors. First, the personal experiences for each individual, and second, through cultural heritage, family norms, moral education build up our general perception of the world (Douglass C. North, 1990) (Wei Li, 2009) (Claude Ménard, 2011).

Our decision is highly dependent on informal institutions, cultural heritage, moral education, which roots back to several centuries. The second factor of North is fundamental to understand, as actions by actors of an institutions are limited to these informal aspects. Thus, a member of an institution is limited to a certain degree, to induce changes within the framework of a particular institution; the efficiency of these changes is dependent on their informal institutions. Therefore, human interactions have to be controlled and improved to sustain efficiency. However, these informal institutions are difficult to deal with, “*superstition, religion, cultural heritages, regional norms are factors which*”, on the short run is unmanageable to modify or even influence, while on the long run it is exceptionally problematic to do so (Douglass C. North, 1990) (Claude Ménard, 2011). Even though institutions are regulated and controlled by formal rules, these are strongly linked with the informal aspects within their framework. “*Informal institutions advance formal laws and rules to go beyond, and extend them to be able to solve real life problems and to be able to function on full efficiency*” (Douglass C. North, 1990). Based on different economic theories, perfect information is available for markets, and for actors of these markets, plus everyone acts rationally, according to complete information. Nevertheless, North claims, that it is not the case, and both actors and markets have imperfect information, limited knowledge, acting rationally is not always the case, and also the feedback they receive on those actions is insufficient. Limited rationality, and information is a core of

our Non-Ergodic world, no one has unlimited information in a world of uncertainty. For instance, in blackjack, it is uncontrollable to have information on the closed card of the dealer, as in case of an institution how the actions will manifest in real life is bounded to uncertainty. Furthermore, North believes, institution policies are improperly applied as a reason of informal institutions, thus, institutions are never perfect. To achieve a state where institutions would function perfectly, the costs to get there would surpass possible gains, thus, the whole payoff would lose its importance. One of the main roles of a formal institution is to decrease the level of uncertainty, and to deliver a framework for human interactions (Douglass C. North, 1990).

Regarding the efficiency of institutions, North believes, changes, time, and feedback are fundamental. In his book he highlighted two major factors which are strongly linked to the outcome of changes, *“The resultant path of institutional change is shaped by (1) the lock-in that comes from the symbiotic relationship between institutions and the organizations that have evolved as a consequence of the incentive structure provided by those institutions and (2.) the feedback process by which human beings perceive and react to changes in the opportunity set.”* (Douglass C. North, 1990). Changes in an institutional environment are considered fundamental, as also the external world is changing continually. For instance, one day a market might be a competitive, free market, next day it is monopolized due to rapid technology changes. Times is essential, as what works today might not work tomorrow. Political, economic, and social changes have significant effects on the efficiency of an institution. Another relevant factor in relation to changes is the geographical availability. If an institution functions resourcefully in a region does not mean it will do so in other regions. In an example, when the Latin American countries adapted the US constitution, it did not have immediate results and needed modification. Therefore, organizing institutions according to regional economic and political structures is fundamental (Douglass C. North, 1990) (Claude Ménard, 2011).

#### **4.2.1 Assumptions and Analytical Framework of Douglass North**

It is imperative to mention some fundamental assumptions, presented by North in his books, regarding institutions to better understand the role of formal-, and informal institutions in the China – V4 matter. The first statement highlighted by the author is that well-organized, resourceful institutions create costless transactions. In both an economic and political environment, transaction costs are considerable, and mandatory to deal with. On one hand, there are transaction costs which can be measured, for instance a currency conversation brings

transaction expenses, increasing transaction costs which can easily be measured. On the other hand, some transaction costs are more difficult or nearly impossible to measure, such as costs of gathering information or bribes taken during a transaction (Douglass C. North, 1990) (Wei Li, 2009).

As for the next assumption, North claims, that competent institutions create proper mental models. A mental model is basically a synonym for informal institutions, describing how human beings understand and analyze certain matters. North points out, that organizations which apply precise frameworks will eventually end up with effective decisions, that will lead to economic benefits. While organizations which are fostering a wrong concept, will have to face disadvantages. Furthermore, he argues that establishments using effective models must provide guidance for other organizations. Unfortunately, this does not always occur in real life situations, and regardless of feedbacks many members of institutions will continue to use the wrong model (Douglass C. North, 1990) (Douglass C. North, 2003) (Douglass C. North, 1992). Furthermore, the role of efficient information collection and redistribution of it, within an institutional environment is the next assumption considered by North. Due to the complexity of problems and complicated circumstances it usually carries a high price to gather information. Therefore, the flow of information between institutions are not always smooth (Douglass C. North, 1990) (Douglass C. North, 2003). While the last assumption claimed by North, is that the goal of each organization within an institutional environment is to maximize profit, and to function as efficient as possible according to the general will, realizing common goals. It should motivate the members of an organization to attempt to always be goal oriented. Other factors influencing this motivation of actors are ideology, values and social norms (Wei Li, 2009) (Douglass C. North, 2003).

To be able to apply his theory in practice, North established an analytical framework, which considers four significant ideas. First of all, *“economic (and political) models are specific to particular constellations of institutional constraints that vary radically both through time and cross sectionally in different economies.”* (Douglass C. North, 1990). According to North, when analyzing the role of institution in transnational cooperation, the applicability of a certain economic or political structure must be considered, moreover, the validity in another region or a given time period. Just like the previously-mentioned constitution of the States, which functioned properly in the host country, yet, failed across Latin America. For instance, if China has an economic strategy by an institution within their cooperation with Western European

countries, the very same institutional environment might fail to deliver in the CEE region, due to significant differences in economic, political and social backgrounds. Therefore, the geographical and period limit, institutions function by, have to be analyzed since these factors do not only limit the institution itself but the organizations acting within the framework as well. Moreover, it is fundamental to understand that those limits set by government policies impact economic performance. In order to adapt to these factors, institutions must experience change over time. In order to successfully induce institutional change, there must be a flawless, continuous interaction between members of either an organization or an institution, on a political, social, and economic level. Thus, fostering the transformation process of an institution, which on the long run leads to economic developments (Douglass C. North, 2003) (Douglass C. North, 1990) (Claude Ménard, 2011). In the upcoming case study, it is imperative to consider the applicability of institutions and how to transform them over time. In the China – V4 economic cooperation, the economic, political, and social environment can be considered as rather similar. Even though these countries all have similarities there are some individual qualities as well which might create a need for institutional transformation.

Uncertainty and the lack of rationality are the second aspect of North's analytical consideration. He claims, that *“our preoccupation with rational choice and efficient market hypotheses has blinded us to the implications of incomplete information and the complexity of environments and subjective perceptions of the external world that individuals hold. There is nothing the matter with the rational actor paradigm that could not be cured by a healthy awareness of the complexity of human motivation and the problems that arise from information processing.”* (Douglass C. North, 1990). The author raises awareness about the overuse of the concept of perfect information and rationality by scholars, while in real life cases, the process is very different with bounded rationality and imperfect information. Furthermore, he believes that the action and behavior of individuals are essential in understanding the decision-making process within an institution with limited information. Consequently, behavior of actors within an institution are placed on the second level of his analytical framework. He focuses on mental models, and how the institutional environment guides cooperation within boundaries, to reach a higher pay off (Claude Ménard, 2011) (Douglass C. North, 1992).

For the third level of his analysis North further emphasizes the importance of informal institutions such as ideology, or cultural heritage. He points out how significant role they play and institutions reveal their relevancy to a major degree. He claimed that *„ideas and ideologies*

*shape the subjective mental constructs that individuals use to interpret the world around them and make choices. Moreover, by structuring the interaction of human beings in certain ways, formal institutions affect the price we pay for our actions, and to the degree the formal institutions are deliberately or accidentally structured to lower the price of acting on one's ideas, they provide the freedom to individuals to incorporate their ideas and ideologies into the choices they make.*" (Douglass C. North, 1990) According to North, moral education, cultural heritage, social norms, and other informal institution will, to a major degree, determine actions of a member of either an organization or an institution. Decisions made by these actors are highly dependent on informal institutions which will limit efficiency of formal institutions. The way we tend to formulate and foster decisions is strongly linked with our ideology, and personal ideas. Thus, the third level of North's analytical framework further emphasizes these mental models (Douglass C. North, 1992) (Claude Ménard, 2011).

To round up his analysis, North turns back to the interconnectedness of institutions and their political, economic and social environment. *"The polity and the economy are inextricably interlinked in any understanding of the performance of an economy and therefore we must develop a true political economy discipline. A set of institutional constraints defines the exchange relationships between the two and therefore determines the way a political/economic system works."* According to his analysis, political institutions regulate the market with different polities which can induce economic development if executed properly. As a real-life example, the regulations regarding property rights can be considered, where institutional policies limit competition, and control manufacturing on a given market. Therefore, North believes, that in any case of economic or political analyses, the institutional environment must be included to get a more precise picture (Douglass C. North, 1992) (Douglass C. North, 1990).

### **4.3 Limitations and Applicability of the Theories**

To be able to draw an objective, critical conclusion limitations of neoliberal institutionalism, and of North's theory must be investigated. As for Keohane's neoliberal institutionalism, the harshest critique came from Mearsheimer, in his book "The False Promise of International Institutions". Even though the author went entirely against Keohane's ideas, he supported the idea about the role of institutions from an economic perspective. Mearsheimer argued about the lack of role of institutions from a "peace-keeping" perspective (Mearsheimer, 1994-1995). Therefore, the role in economic cooperation is agreed on, even by two opposite sides.

When it comes to North's work, some scholars debate how he pays way too much attention on individuals throughout his analysis. Based on the assumptions by Heilbroner and Milberg, *"the recognition of the inextricably social roots of all social behaviour leads to the view that macrofoundations must precede microbehaviour, not the other way around."* (Heilbroner R. and W. Milberg, 1995). In other words, they claim that the social norms and other informal institutions are dependent on formal institutions. Furthermore, they believe that institutional frameworks are shaping and improving personal concepts instead of limiting them. Other scholars argue that North conceptualize informal institutions as an individual feature instead of a collective function. These researchers claim that informal institutions develop from a collective background. Thus, the lack of separation between collective and individual informal institutions by North is highly (Dimitris Milonakis Ben Fine, 2003). The last common critique is the lack of emphasize on power and conflict in North's work (Dimitris Milonakis Ben Fine, 2003). However, this aspect has no relevancy for the role of institutions in the economic cooperation between China and the V4. In order to be able to answer the question: *"How do formal- and informal institutions influence the economic cooperation between the Visegrád 4 and China within the 17+1 platform?"* the above-mentioned tool by North combined with general concepts of neoliberal institutionalism will be applied throughout the analysis section. As North's analytical framework presented, three key factors influence the efficiency of an institution, political-, economic-, and social factors. Therefore, in the upcoming analysis section these three levels will be investigated on four different case studies to properly understand the role of institutions in the current economic situation between the V4 and China. Furthermore, after the case study section a brief discussion on the relevancy of the basic assumptions of the theory by Keohane, and North will be combined with the findings of the case studies. As North says, efficient institutions create proper mental models, reduce transaction costs and promote economic development. In this situation, if China and the V4 countries are able to establish the necessary institutional environment, these institutions will support common goals, economic growth. By combining the qualitative data, and quantitative data, the empirical, academic data can be proved right or wrong by adding statistics to it. When the case studies consider a country the economic performance measures will show if an institution had an impact on the cooperation. For instance, when a country joined the 17+1 platform, and had immediate, or short-term impacts, the numbers will provide an insight to it. Furthermore, the ideas of Keohane and North as well suggests the aim for cooperation over individual operations. Therefore, the case studies will investigate if the sides are always aiming for this cooperation equilibrium and if the numbers prove them right.

## **5 Analysis**

In this section, this master thesis will turn to an analysis of the role of institutions in the V4 – China economic cooperation. In order to achieve a comprehensive academic understanding of the topic the previously-mentioned theoretical considerations will be applied throughout the chapter. First of all, analysing foreign policy strategies of V4 countries towards China, and the other way around, will lead this paper towards its case studies.

### **5.1 The V4 Countries' Foreign Policy Towards China**

After conducting a research on the annual reports by Visegrad Group's Presidencies, it can be understood that the V4 countries as a unit lacks a multilateral foreign policy strategy towards China. Based on the presidency reports by each state of the V4, multilateral foreign policy towards China is not present, moreover, the bilateral strategies are also less significant. In these reports the PRC drew just a little attention. For instance, from the report of the Slovak Presidency the only approach highlighted on China was a platform for exchanging information and experience of other V4 states in tourism. (Slovak Presidency, 2015). The Czech government takes it to a higher level, as according to the report a "destination branding" conference was held in 2016, in order to promote imports from China by introducing different concepts of destination branding (Czech Presidency, 2016). Poland works on a multilateral tourism level, as they promoted travel opportunities between the V4 countries and China (Polish Presidency, 2017). While in Hungary, recent years did not produce any multilateral V4 framework towards China and by the recent report of the Hungarian Presidency, China did not get any attention (Hungarian Presidency, 2019). It can be seen that a proper political institutional environment is very much in need on a multilateral level. Developing a multilateral foreign policy strategy would induce institutional environment which would foster the economic cooperation.

### **5.2 China's Foreign Policy Towards the V4 Group**

According Chinese primary sources, the PRC also lacks a multilateral foreign policy strategy towards the V4 as a unit (The State Council, 2019). However, Chinese leaders acknowledge the significance, and possibilities of the V4 region, and multilaterally cooperates with them under the 17+1 platform. China considers the 17+1 platform as a bridge towards Europe which



improves cooperation. Wang Yi claimed, that the PRC was always engaged in cooperation with the CEE region, even before the launch of the 17+1 platform, obeying with EU legislations (Wang, 2018). In 2018, a very first high-level official meeting was held between the PRC and the V4, where Wang encouraged a further engagement from the V4 states in promoting Chinese integration in Europe, in order to further develop transnational operations (Wang, 2018). Furthermore, the unquestionable significance of the V4 countries in the CEE region was acknowledged by the state councillor and foreign minister Wang Yi, and he emphasized the major role the V4 state can play in promoting cooperation. While welcoming the V4 state's encouragement and contribution to the BRI, believing in an opportunity to realize a mutual development and win-win cooperation with the PRC (Wang, 2018). Since China introduced the 17+1 platform, the establishment of an institutional environment can be noticed in the cooperation between the Asian giant and the V4. However, this institutional environment does not directly deal between the PRC and the V4. Nevertheless, by providing institutions for the transnational cooperation, China aims to promote a multilateral economic development.

### **5.3 China's institutional consideration for the 17+1 platform**

To understand China's policy towards the V4 countries, the PRC's approach on the 17+1 initiative must be considered. Under the platform, cooperation between Beijing and the members of the 17+1 are rather individual, each state makes their decisions and agreements bilaterally. However, in order to develop and foster a proper institutional environment, China has launched a "Twelve Measures" framework to promote cooperation with Central Eastern Europe. The agenda begins with setting up a secretariat, which will be responsible for cooperation and communication between the two sides. The secretariat will be based in the PRC's Ministry of Foreign Affairs and all the members of the 17+1 will set up an equivalent agency in their country (Ministry of Foreign Affairs, 2012).

Second point of the agenda was establishing a credit line with the volume of 10 billion USD, in form of mostly concessional loans. The obtainability of these loans is provided by the mayor banks of China, "National Development Bank of China, Export and Import Bank of China, Industrial and Commercial Bank of China, Construction Bank of China, Bank of China or China Citic Bank." Each member can file a project application for loans as long as the project is related to infrastructure development, new technologies or green development (Ministry of Foreign Affairs, 2012). While the third part of the agenda was to set up a fund for investment cooperation with a starting goal of raising 500 million USD (Ministry of Foreign Affairs, 2012).

Fourth measurement was about promoting bilateral economic cooperation and trade. The concept was, that China will “send trade and investment promotion missions” with an aim to promote the earlier mentioned cooperation; and set up a goal to achieve a total volume of 100 billion USD in the two-way trade within the 17+1 by 2015 (Ministry of Foreign Affairs, 2012). As for the fifth point, the government of China assured to encourage Chinese firms to cooperate with countries in the CEE region, furthermore, to establish an economic and technology zone in each country. Thus, promoting appropriate relations between Chinese enterprises and the CEE countries (Ministry of Foreign Affairs, 2012). Boosting efficiency of the cooperation in a financial matter was the sixth measurement. Setting up bank branches in each other’s countries, currency swap, and local currency settlement in order to enhance financially cross border operations (Ministry of Foreign Affairs, 2012). Infrastructure guidelines came seventh on the agenda. China engaged in establishing an advisory committee, to counsel on the “construction of transportation network” between the countries. The execution of these projects would be coordinated by the Ministry of Commerce of China, and by each CEE countries separately. Railway networks, local highways created jointly through cooperation and collaboration (Ministry of Foreign Affairs, 2012). The next point was about cultural exchanges, China offered to hold a forum in 2013 about cultural cooperation between the Asian giant and the CEE countries, and to annually have a similar high-level forum, where culture is the first priority (Ministry of Foreign Affairs, 2012). Considering the future was also part of the agenda, in the ninth point China guaranteed to provide 5000 scholarships for students of the 17+1 countries until 2017. Upholding local Confucius institute, promoting Chinese language studies, university exchange programs, were all part of the agenda in order to emphasize the importance of education (Ministry of Foreign Affairs, 2012). As part of cultural exchanges, China Tourism Administration established an alliance to encourage travel between China and the CEE countries. The initiative allows individual airline companies, and travel agencies from both sides to jointly promote tourism, and cultural exchange. Furthermore, setting up charter flights will not only promote tourism but also encourages cross border business operations. (Ministry of Foreign Affairs, 2012) The last two points of the agenda include a fund for research institutes, to support academic exchanges on the cooperation between the two; and a forum to provide a platform for young political leaders to better understand cultural differences (Ministry of Foreign Affairs, 2012) .

It can be understood that China has a significant interest toward the CEE region. In addition to the twelve-point measurement, a supplementary nine pillars were introduced to sum up the

framework of collaboration. The nine pillars are made of on a concept of economic cooperation, cooperation of industry and manufacturing, cooperation in science, technology, research, innovation, environmental protection, cultural exchange, education, youth support, tourism, healthcare, and agriculture. Therefore, the complexity of a significant cooperation is unquestionable, on numerous levels China and the CEE countries are ready to engage with one another. (Ministry of Foreign Affairs, 2015) Therefore, it can be concluded how China aims to develop, and sustain a proper institutional environment for the cooperation with the CEE countries, which provides guidelines for the cooperation with the V4. By creating, and promoting these formal institutions, information gathering will be easier, and proper mental models will be available to positively influence informal institutions. Furthermore, these institutional frameworks, create a free flow of information, which is essential according to North.

#### **5.4 China and the Visegrad Group economic cooperation**

Economic cooperation between the V4 states and China traces back to as early as 1991. Nevertheless, as it was presented earlier, over the last decade the volume of economic cooperation has significantly decreased in relation to China's increased interest in the Western Balkan region. In order to further comprehend how the cooperation slowed down, in the next paragraphs the economic exchanges between China and the V4 countries will be analysed.

According to appendix 1, there is a massive trade balance between the V4 states and China, just like between the EU as a whole and China. Moreover, it can be concluded that in comparison with the EU as a whole, trade between China and the V4 unit is less significant. The volume of exports to China from the V4 states has been steady, on the very same level since 2010, while the import has shown a vast increase over the years. According to some scholars the PRC has shifted its focus from the V4 countries towards Western Balkan regions regardless of options by the 17+1 platform (Lagazzi, 2018). A possible key aspect for this shift in attention is regarding EU institutions. Researchers argue that avoiding EU legislation bodies, policies, taxes is a significant reason in Beijing's advanced engagement in the Western Balkan. Nevertheless, according to Lagazzi, China is targeting EU regulated sectors within the 17+1 platform and the author believes that the V4 countries represent a possibility to access other European markets for China (Lagazzi, 2018). After conducting a research, it can be considered, that the PRC aims to avoid increasing diplomatic tension within the 17+1 platform. One fact which supports this statement is, that China excluded all countries which are too politically or

economically instable or just simply too closely tied with Russia to join the 17+1 platform, such as Belarus, Republic of Moldova or Ukraine. Regarding the Visegrad Group, recent events indicate a massive political opposition between the V4 and the EU, which attracted criticisms, and which might also drag China into these diplomatic debates. One of the most relevant examples is their policies towards migration as the V4 stood strong as a unit against the EU's migration quota, by completely refusing that. However, for China the V4 countries represent a major political power in the CEE region, and a powerful ally in dealing with EU. For instance, in the Council of EU, individual member states have the ability to influence the final decision when the Council votes on different matters. The Visegrad group represents 58 votes from the total of 352 votes in this structure (Poland 27, Czech Republic 12, Hungary 12 and the Slovak Republic 7) (Council of EU, 2018).

Over the next paragraphs, four case studies will be presented. Each case study will investigate the role of institutions on a bilateral level between China and each V4 country separately. To understand the role of institutions, the case studies will follow key assumption by Keohane, and an analytical framework by North. By using North's analytical tool, each case study will have three different levels of analysis; political, economic and social.

## **5.5 Czech Republic**

### **5.5.1 Political Level**

To follow an alphabetical order, the Czech Republic comes as the first case study country of the V4. Transnational relations between the Czech Republic and China traces back as early as 1919, when the former Czechoslovakia recognized the PRC, and 11 years later, in 1930 launched diplomatic relations (Embassy of the Czech Republic, 2015). Though, from the ex-soviet block the Czechs were amongst the first countries to recognize "One China policy", political conflicts arose when the Czech started to criticize Chinese human rights and Tibet-Taiwan policies in 1995. However, the new administrative office in 2004 has shifted the country's approach on China and turned their attention towards economic possibilities (Embassy of Czech Republic in Beijing, 2018).

Nevertheless, in 2007 the Czech Republic was led by a green party coalition which begun to harshly criticize Chinese policies in Tibet, increasing political tension once more. The Milos Zeman democratic administration launched in 2010, cooperation between China and the Czech Republic rapidly improved. The Czech's government follows an official foreign policy strategy

towards China, and tries to strengthen cooperation with the PRC in sectors such as healthcare, economy, research and development, cultural exchanges, human rights, and environmental protection (Ministry of Foreign Affairs, 2015). According to the report by the Czech Ministry of Foreign Affairs, the country is ready to cooperate with China on a multilateral level under the 17+1 platform, and the EU – China strategic partnership (Ministry of Foreign Affairs, 2015). Recent years show a development in terms of multilateral and bilateral cooperation between China and the Czech Republic, even though, the country represented one of the most critical sides in the EU towards China in 2010 (Embassy of the Czech Republic, 2015). However, after the inauguration of Milos Zeman prime minister, the foreign policy strategy changed, and the Sino-Czech relationship started to improve (Cacrlí, et al., 2019).

The cooperation has escalated to such a level, that in 2014, the Czech Republic held the “2<sup>nd</sup> China – CEE Local Leaders’ Meeting” in Czech capital. The sides signed a “*Memorandum of Understanding on Promotion of the Establishment Association of Governors of Provinces of China*”; and a document about nuclear energy cooperation (Cacrlí, et al., 2019). The improved relationship led to the 1<sup>st</sup> “*China – CEE Health Ministers’ Forum*”, where the parties signed a cooperation document on health issues, furthermore, signed the “*Memorandum of Understanding on Jointly Building the BRI*” (Fojtikova, 2017) (Cacrlí, et al., 2019). While in 2016, the Czech Republic signed a Memorandum on digital connectivity under the Digital Silk Road cooperation. All these agreements, documents, and memorandum, furthermore, the regular high-level official meetings suggest the aim to provide an institutional framework for cooperation from both sides. These documents function as a formal institution, setting down boundaries, and regulations to promote economic development and efficient cooperation. Regardless of the promotion of an efficient bilateral relationship, earlier this year, March 2020, Czech Prime minister Andrej Babis said that the Chinese ambassador in Prague must be replaced. The tension started to grow as the ambassador sent a letter to the Babis administration, that China would retaliate against Skoda and other major Czech companies operating in China, if a certain Czech high level official (Jaroslav Kubera) would visit Taiwan as part of a conference. Yet the political relationship is relatively decent, the Czechs support China’s foreign policy towards Taiwan and the whole situation was not more than an ambassador overstepping its own responsibilities (Reuters, 2020). These political institutions serve as a tool for cooperation, in form of an accelerated information exchange which leads to reduced transaction costs. Furthermore, by creating proper mental models about the cooperation, thus reducing weak informal institutions. When an actor of an institutional environment realizes how

others approach work, how they consider cooperation, the individual ideas, norms and cultural heritage might stay in the background, leading to more efficient decisions. Moreover, as North says there's a massive uncertainty in our world but these political institutions reduce the level of uncertainty further providing space for economic development.

### **5.5.2 Economic Level**

In order to understand economic institution within the China – Czech Republic framework, the key factors of economic cooperation must be analysed. According to North the institutional environment on an economic level highly influences economic development by providing a framework for efficient cooperation. The PRC ranks as the 2nd most significant import- and the 18th most important export partner for the Czech Republic. Researchers claim that over the last couple of years, the bilateral economic cooperation between the sides has been developed significantly due to the mutual agreements and developed institutional framework (Li J, 2017) (Cacrlí, et al., 2019). To promote the development of their institutional framework, and to further improve trade relations, in 2014, Prague was home for the China Investment Forum, and by promoting bilateral ties the PRC attended the Czech's International Engineering Fair in Brno. In 2016, regardless of usual mutual agreements, the Czech Ministry of Interior criticized Huawei, and based on reports by the Office for Foreign Relations and Information claimed that Huawei proposes a great threat in the technology sector with a high risk of industrial espionage; and all the cooperation must be suspended indefinitely (Daily, 2016). However, the economic cooperation between the sides is still relevant. One of the main actors from the PRC in the Czech Republic is the China Energy Company Limited (CEFC); the corporation focusses on the energy sector and monetary solutions. According to financial reports, the CEFC has invested around 5 million euros in the Czech market and own a minor (10%) part of a Prague-based financial group called J&T Finance Group (Debiec, 2018). In 2016, the CEFC further engaged in the Czech market by acquiring 49% of shares of "Empresa Media". Moreover, the CEFC also prioritize the airline sector and made a major investment in the Czech Airlines, acquiring almost 79% of shares (Cacrlí, et al., 2019).

According to data by the Observatory of Economic Complexity, China ranks as the second biggest source of import for the Czech Republic (Observatory of Economic Complexity, 2020). As it is shown in Appendix 2, both imports from China and exports to China have been significantly growing since joining the EU in 2004. Furthermore, after 2010 when the Zeman administration was established, the economic cooperation has shifted to an even higher volume

in a relation to the new era's foreign policy. As it was mentioned earlier the rate of import is considerably larger than exports in all V4 countries, the same goes for the Czech Republic; as in 2017 they recorded a 17.22 billion USD trade deficit in 2017. Criticisms arrived in 2017 about the massive trade deficit when the Babis administration took over control with ANO. In relation to the negative trade balance the Czech prime minister, Babis, claimed *"we buy [in China] ten times more than we sell, despite so many ministers having travelled there – so I do not know what for"* (Ladislav Zemánek, 2020). Therefore, a monetarily created tension can be identified between the sides, and the Czechs are aiming to balance the trade with the PRC in order to achieve higher gains. According to both North and Keohnae, the political leadership must support the institutional environment, however, if there's tension or disagreement, they might not pay the necessary amount of attention.

Regarding exports, based on OEC data from appendix 3, the Czech Republic's main exports to the PRC are vehicle parts (9.3%); liquid pumps (5.8%); low-voltage protection equipment (4.6%); electrical lighting and signalling equipment (3.1%); non-optical microscopes (2.8%); chemicals (3.8%) and other minor sectors. It is easily concluded from the numbers that Skoda with Czech roots dominates the exports. While in terms of imports, according to appendix 4, most of the Czech imports from China concentrates around broadcasting equipment (19%); office machine parts (13%); computers (16%); vehicle parts (1.1%); integrated circuits (1.8%); and other consumer goods. In both export and import there is a trace of raw materials, finished products, both consumer and capital goods as well. Even though, the balance is in an uneven state, creating a massive trade deficit for the Czech Republic, researchers argue that a significant portion of these imported goods from China are later exported from the Czech Republic to other countries (Cacrli, et al., 2019) (Observatory of Economic Complexity, 2020).

When it comes to Chinese FDI for the Czech Republic, the very first agreements date back to 2005, a year later after the Czech became part of the EU. A 14 points agreement was signed by Chinese and Czech prime ministers in order to promote mutual cooperation in economics, politics, and cultural exchanges. Researchers believed, that the sides had dedicated themselves towards cooperation and this agreement will make a steady monetary inflow of Chinese capital in to the Czech Republic, by promoting and protecting investment (Deloitte, 2019). As North claimed, by setting up economic institutions, the sides can make cooperation more efficient, by defining guidelines. These institutional attempts will result in maximizing goals, reducing transaction costs and by modifying them over time the efficiency of the cooperation will significantly increase. As a result of the newly set institutional environment, the CEFC launched

its very first headquarters in Prague, at the same time as Ye Jianming became advisor to President Zeman in 2015. The immediate impact of the institution is present, and it is supported by different organizations. According to an article from the South China Morning Post, the PRC shows a great interest for cooperation with the Czech Republic in sectors such as car manufacturing, industrial sector, science-technology, healthcare, and civil aviation (Lau, 2020). The major organizations in the institutional environment of monetary investment are: Shanghai Maling, Changhong, Shanxi Yuncheng and YAPP Automotive Parts (Deloitte, 2019). Based on a review on Chinese investment in the Czech Republic by a European Think Tank network, Beijing acquired organizations and shares in soccer teams, breweries, financial groups, hospitality services in Prague, and airline firms (John Seaman, 2017).

However, regardless of the dedication the sides showed, economic cooperation remains way below the expected numbers. Earlier in 2020, President Zeman showed his concerns about China, and claimed that in terms of investment Beijing is underachieving its own promises (Lau, 2020). This claim is closely related to inefficient institutions. The formal economic institution has been set up, with great promises, however informal institutions, individual decisions from one side overrule the efficiency of the formal institution.

When President Xi Jinping visited Prague, the Chinese leader guaranteed a massive investment project of 10 billion euros. Yet, FDI from the PRC accounted for less than 1% of the total FDI arriving to the Czech by the end of 2017; even other Asian countries have invested more, Japan or South Korea (Kafkadesk, 2019). However, the institutional environment is not completely failing to deliver as China has increased their attention towards the Czech energy sector over the last couple of years. Regardless of the interest from China, some Czech officials argued to leave energy sector investment for NATO countries to avoid breach of security. Even with the increased attention, the Czech Republic acquired the least of Chinese monetary investment in energy sectors throughout Europe, in relations to security concerns (Richard Q. Turcsanyi, 2016) As both Keohane and North suggests, efficient institutions on an economic level will generate, on the long-term, economic development. In the case of the Czech – Chinese bilateral relationship, the sign of institutions, and some monetary results of them can most certainly be identified. However, further development of the institutional environment is required to maximize efficiency of the economic cooperation.



### 5.5.3 Social level

According to North, informal institutions have the most impact on economic development, and these social factors influence the efficiency of formal institutions. However, formal institutions can also serve a great purpose on a social level. Looking at the bilateral cooperation between China and the Czech Republic several institutions and organizations have been set up on a social level. In 2007 a Chinese cultural centre was established in Prague to promote the diverse culture of the PRC (Jakobowski & Kaczmmarski, 2017). In hopes of resourceful cooperation cultural ties have further been engaged as in 2012, the Czech – Chinese Friendship Association was launched, followed by, in 2014, a Czech – Chinese Cultural and Art Exchange Association in Prague. Furthermore, a Confucius Institute at the prestigious Palacky University (Fojtikova, 2017).

In order to emphasize the significance of informal institutions in economic development, the next paragraph will provide an insight into institutional corruption. North believes, that these individual decisions, and the source of diverse moral education can fundamentally worsen the efficiency of an institutional environment. According to GAN Integrity's corruption report, the numbers shown a steady increase over the last couple of years. Based on their reports, the Czech Republic experiences a high risk of corruption in both public procurement, and administration sector as well, yet the majority of citizens do not encounter corruption activates on a daily bases (GAN, 2017). According to researchers, the lack of effective implementation of anti-corruption framework by the government induces these events. In other words, it can be considered as an ineffective use of an institutional environment, where unwanted informal institutions dominate the agenda. Moreover, studies highlight the regular corruption in the justice department, as bribes and irregular benefits are a common factor (World Economic Forum, 2017). Therefore, it can be seen how massive roles informal institutions play in economic development, since as long as the individual goal is more attractive for citizens then common goals, the pace of economic development will be a lot slower. This case entirely aligns with assumptions of North about the significant influence informal institutions have in a society.

## 5.6 Hungary

### 5.6.1 Political Level

When it comes to the bilateral relationship between China and Hungary, the two sides traces cooperation back for thousands of years, in a form of an endless relationship. As a reason of this special connection, in October of 1949, Hungary was amongst the very first countries in the world to recognize the People's Republic of China. In 2004, after Hungary's entry to the European Union, the country's strategic importance grew for China, and the bilateral association of the two has further strengthened. Major events proved the legitimacy of the special relationship, as a "*Friendly Partnership Cooperation*" statement was signed by the two sides to further engage in cooperation to induce mutual benefits. This can be considered as a start of a new era in terms of economic development. Yet another imperative breakthrough occurred in the bilateral relationship, when prime minister Viktor Orban, launched a new foreign policy strategy for Hungary, called the "Opening to the East". As part of this initiative the Hungarian prime minister sought to reduce the Hungarian economy's level of dependency on other EU member state and the European Union, and projected an alternative to tighten economic cooperation with states from the East. Orban claimed, that an "eastern wind is blowing in world economy" and Hungary must adapt to it to induce economic development (Agnes Szunomar, 2017). Moreover, the prime minister added, that besides other Eastern countries, the PRC might be an alternative to initiate progressive influences on economic growth in the country. A year after his speech, in 2011, Orban visited China to promote bilateral cooperation, and as a result, Chinese premier Wen Jiabao, visited Hungary on his short tour in Europe. On this tour the Chinese premier visited only two other countries ( England, Germany) which emphasizes the strategic position of Hungary for the PRC (Hungarian Embassy in Beijing, 2019) (Agnes Szunomar, 2017) (Sabina Carli Faris Kocan Nina Pejic, 2019).

It can be concluded, that the Hungarian government, the most significant political institution in the country, is aiming towards strengthening the bilateral relationship, and to maximize its efficiency. Regardless to a lack of official foreign policy strategy from Hungary to China, the political relation is characterized by regular high-level meetings. Following the Orban, and Jiabao visit, on the first official meeting of "Heads of Government of China and Central and Eastern European Countries" in Warsaw, Orban had a bilateral meeting with president Xi Jinping. While in 2013, the second official 17+1 meeting took place in Bucharest, where further talks between Orban, and Chinese premier Li Kequiang took place. A year after Orban visited

China where he met several leaders of the PRC, president Xi Jinping, Li Keqiang, and also the Chairman of the Standing Committee of the National People's Congress, Zhang Dejiang. Not only Orban is active in promoting the bilateral political relationship but also Peter Szijjarto, Hungarian Minister of Foreign Affairs and Trade met Wang Yi his Chinese counterpart in 2014. Later that year, Orban yet again met Li Keqiang on the third official CEE meeting in Belgrade. In 2015, Wang Yi visited Hungary, where he met with Szijjarto, Orban and also Janos Ader, the president of the republic. (Hungarian Embassy in Beijing, 2019) According to Keohane and North, political institutions provide such a framework, where organizations and economic-, and social institutions can fully fill their potential. In case of the bilateral relationship between China and Hungary, the dedication to improve these institutions can be identified from both sides.

The Hungarian minister of foreign affairs, in 2015, visited the capital of the PRC, on the occasion of the 70<sup>th</sup> anniversary of the Anti-Japanese War, and this visit meant a meeting for the second time in the same year between Hungarian and Chinese high-level officials. Furthermore, Szijjarto attended one more meeting with Vice-President Li Yuchano on his tour to Beijing, to foster mutual interests (Embassy of the People's Republic of China, 2019). As part of the 4<sup>th</sup> official 17+1 conference, a meeting between Chinese, Hungarian, and Serbian high-level officials took place, where they signed transnational cooperation agreements regarding the renovation and expansion of the Budapest – Belgrade railway system, which is considered as a major strategic factor for the Belt and Road (Agnes Szunomar, 2017). On the occasion of the China – CEE Political Parties Dialogue in 2016, Orban attended a meeting with a member of the Political Committee of the Communist Part of China, Liu Yunshan. As part of this meeting, Orban promoted the idea to further commit to the multilateral relationship within the 17+1 platform, to an advanced strategic partnership with higher commitment. By mutual agreements on a bilateral level, Hungary and China launched a “*China – Hungary Belt and Road Working Group*” institution, to further promote political, economic, and social connectedness (Agnes Szunomar, 2017). Another meeting took place between Chinese and Hungarian representatives in 2019, where the sides discussed the importance of promoting tight political connectedness, the fundamental significance of the expansion of the Budapest – Belgrade railway line, mutual goals in agricultural cooperation, and the possibilities of the BRI projects. Moreover, they emphasized the implication, development, and sustainability of institutions which can encourage bilateral monetary investment, trade, and economic development. The major institutions included the “*China-CEEC Ministerial Meeting on Promoting Trade and Economic Cooperation, the China-Hungary Economic Joint Committee*

*and its Working Group for Unimpeded Trade, and trade and investment promotion platforms such as the China International Import Expo and the China-CEEC Expo” and they all received close attention, in relation to their ability to form an institutional environment around the cooperation, where the economy can develop (Sabina Carli Faris Kocan Nina Pejic, 2019) (Hungarian Embassy in Beijing, 2019) (Embassy of the People’s Republic of China, 2019).*

According to North, political institutions provide a structure for economic development. In the China – Hungary relations, several institutions can be identified, which are aiming to strengthen the bilateral ties from both sides. These institutions are set by political forces yet they sometimes act on an economic level. By the establishment of numerous institutions in the bilateral cooperation, the theory of North proves its significance. The two sides aim to reduce uncertainty, improve the flow of information, reduce transaction costs, and to provide proper mental models.

### **5.6.2 Economic level**

When it comes to an economic level of the China – Hungary bilateral relationship, the Hungarian economy is concentrated around the European Union, just like any other V4 state. Regardless of this similarity, in Hungary the Chinese monetary cooperation began to show its strategic importance over the last decade as the PRC became the largest trading partner for Hungary outside the EU (Eszter Lukács – Katalin Völgyi, 2018). Regarding the capacity of import, the volume has experienced a steady increase during the period between 2000 and 2017, as numbers show, the import from the PRC grew from an annual 0.9 billion USD in 2000 to 5.78 billion USD in 2017. While the annual volume of imports was around 5 billion USD in 2016, this number grew by almost an annual billion USD by the end of 2017 (Observatory of Economic Complexity, 2020). When it comes to the volume of exports, numbers show that Hungary exported to China an annual 3.14 billion USD worth of goods in 2017, highlighting a massive growth compared to an annual 0.04 billion USD in 2000. When we look at the last two years (which are available by OEC) a yearly 1 billion USD growth can be visualized by the statistics. This massive growth can be understood as the impacts of the strengthening bilateral relationship between China and Hungary, and the impacts of the efficient institutional environment. Moreover, capacity of trade is one of the largest in the V4 region, which shows the strategic importance of Hungary, making the country a fundamental actor for the 17+1 platform (Agnes Szunomar, 2017) (Observatory of Economic Complexity, 2020).

Ever since the beginning of the new millennium, the improved economic relationship between China and Hungary created observable financial results. When it comes to imports, China is a key partner for Hungary, and the PRC always ranked in a high position since 2005 with a massive volume of exports to Hungary. This massive volume means, that Chinese trade has increased by 250% of imports in Hungary between 2003 and 2012 (Observatory of Economic Complexity, 2020).

As Appendix 5 shows, the exports from Hungary to China is on a considerably lower level when compared to imports. China ranks as the 11th amongst all the export partners of Hungary in 2017, representing only 2.9% of annual imports. Even though the numbers are seem to be relatively low, it has shown a steady increase since 2000, making the PRC the second largest export partner for Hungary after the US. However, the massive imbalance between imports and exports generates a considerable trade deficit for Hungary (Tamas Matura, 2017) (Observatory of Economic Complexity, 2020). Furthermore, appendix 5 visualizes the data from the OEC, showing the previously-mentioned negative trade balance between China and Hungary. While the red line reveals the level of import from China to Hungary, the blue line indicates exports. In direct proportion with the increase of both exports and imports, the trade deficit has increased as well. By the end of 2017, Hungary realized a 2.64 billion USD trade deficit from the bilateral economic cooperation. Even though the volume of trade imbalance seems massive, the monetary cooperation between the two sides account for a nearly 3 billion USD decrease in trade deficit over the last 10 years, from an annual 5.56 billion USD in 2008 (Observatory of Economic Complexity, 2020).

In Appendix 6, the exports divided between products shows which goods add most to the negative trade balance between China and Hungary. Based on OEC data, cars stand for 30% of all exports from Hungary to the PRC with a total value of an annual 0.9 billion USD. While, spark ignition takes up 7.5% of exports and totaled at 0.23 billion USD, followed by vehicle parts with 5.2% and an amount of 0.16 billion USD in 2017. Therefore, it is essential to understand how the car industry divides most of the share of all the exports. Other consumer and capital goods, such as electronical devices, medicines, processed food, etc.; amount to only a minor share of total exports (Observatory of Economic Complexity, 2020).

The next appendix, appendix 7, shows what goods Hungary imports from China. Electronic devices lead the imports with telephones 11%, office machines 9.2%, broadcasting Accessories 8.5%, LCDs 8.3%. The capacity of electronic devices adds up to an approximate 70% of total

imports. These products cover the most significant part of imports, which lead to the negative trade balance. However, according to researchers, a large portion of imports coming from China will be reexported from Hungary, producing additional income for the country (Agnes Szunomar, 2017) (Observatory of Economic Complexity, 2020). As it was presented earlier, several institutions have been set up to control economic cooperation. This idea is parallel with North's take on institution to promote growth.

Regardless of a slight decline in Chinese FDI over the last couple of years, Hungary still, by far, dominates the V4 countries and the CEE region as well. Similarly, to other V4 countries and 17+1 members, Chinese FDI started to show a considerable growth after 2004, when the country joined the EU. According to Chinese reports, the PRC's commitment for larger investment realized a massive growth from 5.43 million USD in 2003 to over a hundred times more, 571.11 million USD in 2017. Based on reports by scholars, single handedly Hungary received 89% of the whole Chinese investment in all the CEE region (Chen Xin, 2012). As the other 17+1 members started to intensify their commitment towards China this portion of FDI started to decrease in Hungary but still remains the most attractive in the region for Chinese investment. However, regardless of the escalating Chinese investments, based on data by the Hungarian Central Bank, 62% of all investment to Hungary are coming from other EU states, and China only adds up to a 2.3% of shares in total. (Agnes Szunomar, 2017) Following the empirical considerations of North, Hungary established such an institutional environment where the bilateral economic cooperation might fulfill its potential.

Further investigating the role of institutions in the China – Hungary context, “Eastern opening policy” had significant impacts. Though, the Orban government has claimed that it would like to preserve Hungary's durable and vital economic relations with its European associates, the main goal of the EOP was to decrease Hungary's economic dependence in trade with other European countries, by refining economic relations with China. As a reason of the popularity of Hungary to Chinese investors, the first office of the China Investment Promotion Agency set up its first oversea office in Budapest. This office and the considerable size of Chinese citizens living in Budapest, guarantees information and security for Chinese investors who lack Hungarian market information. Which stands parallel with Keohane, and North's take on the role of institutions in reducing uncertainty. Multinational enterprises and state-owned enterprises have also shown activity on the Hungarian market, in industries like real estate, logistics, banking, telecommunication, electronics and motor-vehicle (Eszter Lukács – Katalin

Völgyi, 2018). Already in 1998, Changsu Standard Part Factory acquired a Hungarian screw factory and started operating in the country. Bank of China opened its first subsidiary in Budapest, 2003, as a first body in the CEE region. 2012, brought a second branch for the organization, while in 2014, Bank of China has set up a headquarter in Budapest which provides financial support for Chinese companies to conduct business in Hungary, and the CEE region (Eszter Lukács – Katalin Völgyi, 2018) (Agnes Szunomar, 2017).

After joining the EU in 2004, Hisense, a manufacturing company established a joint venture with a Hungarian partner, Flextronics. As the commitment to market growth, in 2006, Hisense set up its own manufacturing hub in the country. Lenovo also arrived with the EU accession, and acquired an old IBM factory in Hungary. Ever since the commitment grew, and by cooperating with local manufacturers, Lenovo has reached to a level where they provide products to all over Europe, Africa and the Middle East. Huawei also identified potential in the country. An office in 2005, while in 2009 the company decided to relocate their European supply center to Hungary, from where they distribute products to Europe, Russia, North Africa and the Middle East. Due to good results, in 2013 Huawei opened a new logistic center, and in 2014 an innovation center. ZTE arrived in 2005 with a representative office and a subsidiary in 2010, and ever since continues to operate on a high-level in Hungary. Even though BYD electronics arrived in 2008, until 2017 they were rather inactive. However, in 2017 they established their first European electronic bus factory, which has received a 25 million USD credit line from the Development Bank of China to further expand activities. Member of the over productive Chinese solar industry, Beijing Sevenstar Group also identified opportunities on the Hungarian market. With the help of Bank of China, Wanhua acquired a Hungarian company BorsodChem in 2011, and as a result they became the world's third largest isocyanate producers. They set up a trade cooperation within Hungary with a capital of 230 million USD to lure further Chinese biotech and medical companies. Furthermore, as part of the BRI one of the largest scale project is the Budapest – Belgrade railway line which will be the biggest investment in the country (Eszter Lukács – Katalin Völgyi, 2018). Not only the big players but also small and medium sized enterprises got attention in the bilateral economic relations. In order to encourage SMEs to enter each other's market, Chinese state-owned trading houses were established to guarantee a platform for SMEs to trade their goods overseas. This trading houses provide a role of a middle man to connect smaller entities with a massive foreign market. In 2013, the government of Hungary initiated a “state-owned National Trading House” and

created 30 offices abroad in countries like China, Saudi Arabia, and Russia (Agnes Szunomar, 2017) (Eszter Lukács – Katalin Völgyi, 2018).

Following the previously introduced assumption of Keohane, and North, but even Mearsheimer claims that institution play a massive role in economic development and market expansions. In relations to the significance of institutions, The Hungarian Ministry of National Economy, alongside the Trade and Investment Agency targets to foster such an economic institutional environment where the economic cooperation can further develop. By encouraging collaboration between export financing state banks, and by providing higher responsibility for economic diplomats abroad, who would serve as a significant representative of different institutions (Agnes Szunomar, 2017). Several other committees, business forums, and trading chambers enjoy higher attention besides the previously listed institution in a cross-national take on providing a functioning institutional environment for development. It can be understood that ideas of North and Keohane about cooperation has its significance in real life issues. To further show its significance another example, when the Hungarian Chamber of Commerce and Industry established numerous new departments in order to further improve economic cooperation. To emphasize the commitment level of Hungary to the countries' Eastern opening policy which serves as a functioning institutional environment for transnational cooperation, several examples can be highlighted. The huge attention on transnational organizations, the new business forums, all the high-level meetings are evidence on institutionalization. Furthermore, the Eastern Opening Policy was not the first take from Hungary in encouraging cooperation with China. As in 2004, the country launched its consulate in Shanghai, while a new consulate was introduced in Chongqing in 2010. In relation to connecting with China, newly established organizations were introduced by mutual engagement, such as the Hungarian–Chinese Economic Chamber and the Chinese–Hungarian Business Committee. Moreover, Hungary introduced a new regulation for investors outside the EU, who can apply for resident permit in the country when their investment reaches a certain level. This take is unique in all of Central Eastern Europe, and Hungary tries to provide a guarantee for investors to be able to easily monitor their business operation (Agnes Szunomar, 2017) (Eszter Lukács – Katalin Völgyi, 2018) (Hungarian Embassy in Beijing, 2019).

Several other institutions have been introduced within the 17+1 platform which further acknowledges North and Keohane's idea. Moreover, to further prove the relevance of the theory of institutions by North.



In 2015, a memorandum by Hungary was signed, the *“Memorandum of Understanding between the Government of Hungary and the Government of the People’s Republic of China on Jointly Building the Silk Road Economic Belt and the 21st Century Maritime Silk Road”* (Hungarian Embassy in Beijing, 2019) (Douglass C. North, 1990). Reducing uncertainty, providing a structure for the unlimited flow of information, are all responsibilities of institutions, which serve as a fundamental goal in establishing them. Therefore, EXIMBANK and China EXIM introduced a credit line agreement, to induce economic development between China and Hungary. In 2013, a *“Bilateral Swap line Agreement between Central Bank of Hungary and People’s Bank of China”*. Even before the launch of the 17+1 initiative, several economic institutions were already functioning (*“Investment Guarantee and Double Taxation Agreement (1991) Treaty on Mutual Civilian and Commercial Legal Aid (1995) Agreement on the Approved Destination Status of Hungary (2003) Economic Cooperation Agreement (2004)”*) (Hungarian Embassy in Beijing, 2019) (Douglass C. North, 1990). According to scholars the strategic relationship between China and Hungary has not yet developed to its full potential, and the future holds great expectations (Tamas Matura, 2017). Furthermore, as North suggests, organizations add the extra value for institutions. In this case study, several economic organizations have been identified which improves the institutional content.

### **5.6.3 Social Level**

From a social perspective, Hungary is an outstanding partner of China, and no other members of the V4, or even in Europe has the same relationship. Even during the ancient Silk Road times, the two sides showed economic cooperation, and at the time Hungary was one of the most significant trading partners of China. 1000 of years of cooperation and achieving mutual benefits creates a unique perception of China in Hungary, as most Hungarians consider China as an ancient ally of the (Gergely Salát, 2009). On a social level, institutions are established to promote educational, and cultural exchanges, in which the two sides are highly engaged. There are a high number of Hungarian students who are studying in China, and Chinese students in Hungary, a Confucius Institute in Budapest, and bilingual primary-, and high schools in the Hungarian capital are all results of social exchanges. Not only Hungary but the PRC promotes social institutions as well, Beijing showed commitment in form of a bilingual education center, a language and music center. According to North, these formal institutions

serve as a moral educational tool to improve informal institutions (Embassy of the People's Republic of China, 2019) (Douglass C. North, 2003).

Besides the previously listed, the two sides engaged themselves to further encourage cultural exchange, and new platforms were introduced. Exhibitions, film festival, concerts, summer camps and different cultural forums. More over Hungary is not just the home of the largest Chinese community in the region, but also tourism is on a high level between the countries (Embassy of the People's Republic of China, 2019).

All the established social institution would suggest a developed informal institutional environment in the bilateral relationship. However, according to North, individual decisions, and social norms are the most significant informal institutions which must be analyzed. Regardless of moral education, Hungary experiences a high level of corruption which questions the legitimacy of social norms in the country. Furthermore, North claims that regulations are breeched when actors hope higher benefits with less penalty. Based on reports by GAN Transparency, Hungary ranks at a rather terrible position, 116<sup>th</sup> most corrupted country in the world. Based on their method, the country is considered as most corrupt among all V4 states. Individual rewards, and profits enjoy a high priority for a vast number of citizens in the country. Violations often occur, as the personal gains are usually exceeding the volume of punishments. Based on a report by GAN anticorruption agency: *“corruption in Hungary represents significant risk to business, particularly in the tax administration, and public recruitment sectors...”* (GAN, 2017). Dedication towards collective, common goals is absent for a major percentage of Hungarian citizens, therefore their informal institutions often damage cooperation (Transparency International, 2019) (Douglass C. North, 1990) (HVG, 2018).

## **5.7 Poland**

### **5.7.1 Political Level**

Just like the case for Hungary, Poland has a long history with China, which traces back as early as 1245, when Poland was dealing with China along the ancient SilkRoad. As a result of good relations Poland was the second country in the world to establish diplomatic relationship, and first country to sign a strategic cooperation agreement with the PRC in 1951 (Gadzinowski, 2016). Among other V4 states, Poland represents a country with a clear foreign policy towards

the PRC. Based on their foreign policy strategy, Polish Foreign Policy Strategy 2017 – 2021, the country aims to improve cooperation possibilities with China under the BRI, and 17+1 platform. As part of their strategy, a “Go China” initiative has been launched, which carries a goal to establish improved cooperation with non-European countries, especially China (Ministry of Foreign Affairs Republic of Poland, 2017). The last decade shows an improved relation between China and Poland both on bilateral and multilateral level as well. In 2011, Bronislaw Komorowski, president of Poland, visited Beijing and has signed an agreement about a strategic “*Polish – Chinese partnership*” under the “Go China” framework to promote bilateral ties (Bonikowska & Ostrowska, 2017). On a multilateral level, the very first 17+1 platform took place in Warsaw, which also emphasizes good relations between the sides. Furthermore, the government of the two sides have signed a memorandum of agreement about supporting projects of the BRI. A formal political institution has been launched in 2015, as a form of an intergovernmental committee. As part of his visit to Poland, Xi Jinping signed a strategic partnership program with the Polish administration in 2016, in order to emphasize the significance of mutual cooperation. According to researchers, the Polish leadership is pursuing the most complex and developed institutional environment on a bilateral level with China, in order to gain competitive advantage in the region (Justyna Szczudlik, 2016). Furthermore, several transnational forums take place to promote this goal. Based on official data Poland is aiming to fully apply North’s idea to pursue common goals with a developed institutional environment, which will lead to significant growth in their economy, and decrease dependency of the country on other EU member states. However, one of the most significant accomplishments which explains how political institution promote economic cooperation, is the 2013 strategic partnership between China and Poland. In the same year, there have been more than 25 high level official diplomatic meetings between Poland and China (Ministry of Foreign Affairs of the PRC, 2013).

### **5.7.2 Economic Level**

When it comes to economic relationship between China and Poland, it is imperative to mention that the Polish government was cofounder of the Asian Infrastructure Bank (AIIB). Such an investment shows the relevance of a highly developed transnational cooperation, even though Poland boosted the launch of AIIB by accruing less than 1% of the shares with 831 million USD. Yet, Poland is the only state in the CEE region who was part of the initiative, and their investment guarantees a 1% worth of vote in the decision-making process (Justyna

Szczudlik, 2016). Regardless of the signs of early cooperation with AIIB, Chinese FDI arriving to Poland is considered insignificant, and Poland ranks as only the 8<sup>th</sup> country regarding volume of Chinese FDI in the region (National Bank of Poland, 2018). Nevertheless, the lack of significant investments might change, according to researchers, as the fund of EU structural development fund will stop in later parts of 2020, which would mean that the Polish government must seek for other alternative, and China can become a top strategic partner regarding investments (Mercy A. Kuo, 2017). In this scenario, we can identify Keohane, and North's emphasizes on the importance of an institutional environment. With the EU institution tool functions, the Polish can achieve economic development, and are not in desperate need for another partner for investment. However, when the EU institution tool stops, the country must seek after new investors immediately within a new institutional environment. The EU would still provide aid for development, but the institutional function terminates, in this case it equals the need of seeking new alternatives.

Regarding trade relations, for the PRC, Poland is the largest trading partner within the 17+1 platform, while for Poland, China is the largest trading partner in Asia. Based on data from appendix 8, Poland imported goods from China in an annual volume of 25.9 billion USD. It is by far the largest amongst the V4 countries. Ever since 2004, after joining the EU, this volume of exports has been on the rise, from a 2.3 billion USD annual in 2003. However, when it comes to export, the appendix shows how the export did not go directly proportional with the imports, leaving a huge trade deficit behind. Based on data provided by OEC, in 2017, Poland exported an annual 2.59 billion USD worth of goods to China in 2017. According to these numbers the trade balance accounts for an annual minus 23.31 billion USD for Poland. Just like the other V4 countries show, trading with China ends in a trade deficit, but when one considers the market size and capabilities of the PRC, it is not a surprise that countries 30-40 times smaller, end their trade year in a deficit between exports and imports. Furthermore, just like for Hungary, a significant portion of the imported goods from China will then be further distributed, thus generating extra revenue.

Appendix 9 shows the division of good that make up the Polish import from China, computers (4.9%); broadcasting accessories (7%); broadcasting equipment (6.6%); office machine parts (5.8%); video and card games (3%); light fixtures (1.8%) and vehicle parts (1.5%). While appendix 19 highlights the division of goods regarding export to China, metals (25% refined copper); vehicles parts (6.5%); electronic equipment (electrical transformers 2%; electric filament 1.3% and so on); synthetic rubber (2.6%); seats (2.6%) and other furniture

(3.7%). Most of the companies exporting to China from Poland are operating in the metal industry, one major exporter is a state-owned enterprise KGHM Polska Miedz; while the export is supported by some major players of the private sector, such as Rafako, Fakro, or Bioton (Jusztyna Szczudlik, 2017). When analysing the previously presented appendixes, it can be identified how Poland is most exporting raw materials to China, and import finished products. It means, that the export goods are relatively cheaper, as the price of finished products includes an added value which also takes the trade deficit higher (Jusztyna Szczudlik, 2017).

Looking at the Chinese FDI in Poland, according to a report by Szczudlik, Poland received a year volume of 507.11 million euros as investment in 2016 (Jusztyna Szczudlik, 2017). The division of projects for investment include finance, telecommunication, manufacturing, and infrastructure projects. Regarding finance sector China has elevated its strategic goal, and as of 2016 four branches of Chinese owned banks are providing services in Warsaw (Jusztyna Szczudlik, 2016). Not only the monetary sector but the energy sector of Poland also enjoys a high attention from Chinese investors. A Hungarian researcher working for the China – CEE institute made a study about Chinese engagement in European energy sectors. Based on his findings, availability, affordability, and efficiency are the three-fundamental element for Chinese investors. He claims that the energy sector of Poland enjoys high priority as the country is stable on all three elements (Richard Q. Turcsanyi, 2016). These Chinese investments included focus on acquiring and establishment of coal powered plans, supporting infrastructure, and renewable energy production. Following the ideas of North, a theory about the Polish energy sector can be concluded. If the Polish government follows the assumptions about factors of Chinese interest in the energy sector, and they established an institutional environment that support those factors to attract FDI. Moreover, regarding investments, the China – CEE Investment Cooperation Fund launched monetary operations in the wind energy sector of Poland, and managed to acquire 16% of share from the company Polish Energy Partners (Reuters, 2014). China identifies the strategic possibilities that Poland has, and is ready to fully engage in the country's power plant construction, by establishing a generator in the Polish city Jaworzno, and a new power plant in (Forbes, 2017). While some scholars argue that the energy sector carries high sensitivity for governments, based on Turcsanyi's report, Poland has a positive perception of Chinese engagement in their energy sector (Richard Q. Turcsanyi, 2016). Two factors are highlighted about the positive perception of China, first, the Polish government aims to reduce its energy dependency on Russia and Germany; and second, Poland's strategic goal is to develop coal reserves in which China is a key partner. (Richard Q. Turcsanyi, 2016)

However, minor conflicts appeared between the PRC, and Poland; when Polish authorities arrested a worker of Huawei worker on industrial espionage charges. The case has not yet been concluded but it can be seen how informal institutions influence organizations within an institutional environment. (The Guardian, 2019).

### **5.7.3 Social Level**

According to North social level of institutions is the most crucial, in achieving a functioning institutional environment which promotes economic development. Each country's informal institution is highly dependent on individual and their decisions. Unfortunately, there's always a certain amount of irrational choice, or choices which are promoting personal gains over common goals. Data from the Anti-Corruption agency shows, the level of corruption has been increasing over the period of 2015 - 2018, but have been steadily standing ever since.

Based on reports by the GAN Business Anti-Corruption Portal, the situation in Poland is similar to Hungary, and for operating businesses corruption represents a major risk. According to reports, high level officials overuse their power to achieve individual gains, which has a significant impact on the free market and different business sectors(GAN, 2018). According to North, individuals will aim for personal gains, when in an institutional environment the benefits are higher than the punishment for breaching regulations. In Poland's Criminal Code, money laundering, different kinds of bribes, and extortion are all included, however, based on the report of the country by GAN, the polish judicial system does not follow effectively the procedure to punish offenders (GAN, 2018). Which means, that the assumption of North is relevant in this case, and the corruption will not be demolished as long as there is a higher pay off for breaching regulations than the volume of punishment. The presence of corruption, and widespread of bribes can be experienced throughout the society, as the European Commission reports, that 25% of Polish citizens think overuse of political power, everyday bribery, and breach of regulations at the judicial system is widely spread in the country (European Commission, 2014). For instance, to show an example how complicated the situation is in the Polish judicial system, the polish parliament passed a set of bills about the structure of the Supreme court. Based on their attempts, the ruling party would always have the authority to appoint and dismiss officials as they please in the framework of the Supreme Court, and National Council (The Guardian, 2017). After mass protests the bill did not get passed. Based on the earlier presented assumptions of Acemoglu and Robinson, or North, it is impossible to understand economic or social institutions without understanding the political institution that

created and sustain them (Acemoglu & Robinson, 2008). Therefore, in this case study it was shown how the Polish government is aiming to provide an efficient institutional environment to promote Chinese economic cooperation. The government did not only improve regulations regarding Chinese FDI but also increased its engagement in diplomatic bilateral talks to further improve the relations. As for the informal institutions, it was clearly shown how big of a problem corruption represents in the country. Considering the theoretical assumptions of North, these informal institutions will always damage the functioning of formal institutions as long as personal gains are preferred over common goals.

## **5.8 Slovakia**

### **5.8.1 Political Level**

As part of Czechoslovakia, the country has recognized the newly formed PRC on the 4<sup>th</sup> of October 1949 and set up diplomatic relations. After the parts separated in 1993, Beijing immediately recognized the newly formed states and established bilateral relations with each. 10 years after, in 2003, the Slovakian president visited China where the two sides ended up further strengthening their bilateral cooperation under a strategic agreement (Sabina Carli Faris Kocan Nina Pejic, 2019) (Kristína Kironská and Richard Q. Turcsányi, 2017). Slovakia was an active participant of the 17+1 framework in its early stage, between 2012 and 2014, several delegations were attending summits and the country proposed possible project ideas to China; however, none of them has actually happened. To further improve their position, Slovakia was amongst the first countries to sign a memorandum with China under the BRI, however, the country's involvement was on a rather low level. Regardless of the memorandum, Slovakian PM Robert Fico was amongst the few who missed out on the 17+1 summit in 2016. One year later, for the BRI summit in Beijing, Slovakia did not send any high-level representatives either (Cacrlí, et al., 2019). Therefore, it can be concluded, that considering other V4 countries Slovakia showed the least interest towards China. However later on in 2017, the Slovakian government introduced a foreign policy plan: "*Strategy of Development Economic Relations with China for 2017-2020*". Nonetheless the efforts, Slovakia is only a host for one political institution of the 17+1 platform, the "*Secretariat for technology transfer in Bratislava*." (Sabina Carli Faris Kocan Nina Pejic, 2019) (Šimalčík, 2018). The lack of institutions due to imperfect political structure can be identified, which slows down economic performance in the bilateral relationship. Nevertheless, Slovakia is amongst the few countries in the V4, who has an exact foreign policy strategy towards China, trade and investment is stagnating on a low level (Šimalčík, 2018) (North, 1990).

Eventually, the Slovakian political administration identified the problem of lack of institution and missing diplomatic cooperation. The Slovakian Ministry of Foreign Affairs aims to establish not only bilateral, high level government member meetings between China and Slovakia; but also, on a multilateral level to further improve platforms such as the 17+1 cooperation or through the V4-China cooperation. (Šimalčík, 2018)

### **5.8.2 Economic Level**

As a result of a fragile bilateral political relation, the China – Slovakia economic cooperation is also underachieving, and is considered to be the lowest amongst the V4 countries. Based on appendix 11, in terms of both export and investment the country is not currently meeting the expectations. As for imports, Slovakia is not far behind other V4 countries, for instance, Hungary, as in 2017 the total import from China amounted at 5.69 billion USD. Considering the timeframe between 2014-2017, the total import has been decreasing by around 0.2 billion USD a year. However, considering the last 15 years the imports show a significant growth from only 0.7 billion USD in 2004 to a peak in 2014 of 6.17 billion USD. Therefore, it can be understood that joining the EU in 2004 has induced a growth in imports (Kristína Kironská and Richard Q. Turcsányi, 2017) (Observatory of Economic Complexity, 2020). Regarding export, the amount of Slovakian export to China totaled at 1.84 billion USD in 2017, lowest in the V4 region with a volume of 1.6% of all exports. According to researchers, Slovakia has a more intense trade relationship in terms of export and investment with other Asian countries, such as, Japan, South Korea, or Vietnam; even though, 85.2% of all Slovakian export goes to other EU countries. Compared to 2012 the volume of export dropped back by 50% creating a massive imbalance in trade for the country (Šimalčík, 2018) (Observatory of Economic Complexity, 2020). In appendix 12, the imported goods are divided into categories. In 2017, broadcasting equipment and accessories topped the chart with 15% each, which provides assets to the telecommunication and radio industry. The above-mentioned two, takes up a large share of around 1.7 billion USD of all imports. The distribution of focus between other goods are relatively widely spread but it can be concluded that electric devices dominate the imports, with other finished products and raw materials. China is considered a major import partner for Slovakia as 8% of all imports are from the PRC, only Germany and Czech Republic are ahead (Kristína Kironská and Richard Q. Turcsányi, 2017) (Observatory of Economic Complexity, 2020).

As for appendix 13, the exported goods from Slovakia to China are visualized. The chart is highly conquered by the car industry. Cars with 64%, followed by vehicle parts at 6.5% were



the most exported products in 2017, which means that the car industry takes up a staggering 70.5% of all exports. If we consider other goods such as engine parts with 2.8%, that also belongs to the same industry, a total of around 1.4 billion USD out of 1.84 billion USD comes from similar sources. Unlike for imports, China only ranks as number 14<sup>th</sup> of all destinations for Slovakian export. The difference between imports and export is enormous creating a serious asymmetric trade balance for the country (Observatory of Economic Complexity, 2020) (Šimalčík, 2018).

Moreover, in appendix 11, the previously-mentioned trade balance between China and Slovakia, between the period of 2003 and 2017. It is clearly shown in the appendix that ever since joining the EU in 2004, the trade has started to increase. However, as the imports grew the export did not grow exponentially, therefore a massive trade imbalance is created. In the year 2017, Slovakia accounted a 3,85 billion USD trade deficit. Furthermore, it can be visualized, that the peak gap was in 2014 with a volume of 3,95 billion USD, which has been present ever since, and even though the import decreased, the export decreased accordingly (Observatory of Economic Complexity, 2020). According to researchers of the CEE institute, when it comes to foreign investment from China Slovakia is way behind the V4, and the whole CEE region as a whole. Over the period of 2010-2016 the total of Chinese investment in the country valued at approximately 55 million USD, which is rather insignificant. Regardless of the foreign policy strategy towards China, or the memorandum agreement signed in 2015, Slovakia fell short in terms of luring in Chinese investment. *“In the past, several large investments by Chinese companies in Slovakia were proposed, but none succeeded”* (Sabina Carli Faris Kocan Nina Pejic, 2019) For instance, the case with the acquisition of a US owned steel factory in the country by the Chinese HeSteel Group didn’t actually follow through (Sabina Carli Faris Kocan Nina Pejic, 2019) (Kristína Kironská and Richard Q. Turcsányi, 2017). In comparison to other analyzed countries, Slovakia lacks the proper economic institution structure which could promote economic development.

### **5.8.3 Social Level**

Regarding cultural cooperation, two Confucius institute has been set up by Slovakia. One of them at the Slovak University of Technology in 2007, and another one at Comenius University in Bratislava in 2015. Furthermore, an association has been set up to promote cultural exchanges, the “China – Slovakia Economic & Cultural Exchange Promotion Association”.

The organization is responsible in supporting bilateral educational, research and development exchanges (China – Slovakia Economic & Cultural Exchange Promotion Association, 2019). In comparison to other V4 countries, the cultural exchange is also on a lower level. However, the volume of corruption in the country is the lowest amongst the V4 countries. According to data from Transparency International the country ranks as 36<sup>th</sup> least corrupted country in the world, just a step, in front of Poland. Nevertheless, the presence of corruption has still influenced several different areas. GAN business anti-corruption claims that judicial system in Slovakia. Businesses report unfair treatment when dealing with the court and high presence of bribes in return for favorable decisions, even though the cases are rather significant and a huge capital is involved.: *“Verdicts often lack predictability and are often not properly justified, leading businesses to prefer arbitration to the Slovak court system even in cases involving multi-million-dollar losses.”* The other sector significantly hurt by corruption is public procurement. When corruption comes to public contracts it can block competition which is essential for developing an effective political structure. GAN claims that, *“companies indicate that bribes and irregular payments are very common in the process of awarding public contracts” ... “Two out of every five businesses believe that corruption has prevented them from winning a public tender”* In case of a possible Chinese investment, there is a threat of negative affect of individual decisions, informal institutions (GAN Business Anti-Corruption Portal, 2018) (Transparency International, 2019). As it can be understood there are serious issues regarding informal institutions in the country which damages economic cooperation on a transnational level.

## **5.9 Similarities and Differences of the the V4 Countries**

After analyzing all the 4 countries of the Visegrad group, several institutions have been identified which are either promoting or decreasing the quality of cooperation with China. In most cases, the political institutions have been identified which are aiming to boost economic relations with the help of economic institutions on a bilateral level. However, each country showed a low level of informal institutions, with high corruption rates. According to North these informal institutions are essential to reach a level of efficient cooperation. The informal institutions must develop, and follow the idea of democratic solidarity. Democratic solidarity can be understood as a general idea of being able to forge an agreement or goal with others, which is the basic principle of institutionalism (Hauke Brunkhorst, 2007). The whole idea, the basic principles of democratic solidarity, come from 18<sup>th</sup> century French philosopher Roseau.

Key element of his ideas were about freedom, independence, in a cooperative society. Common goals must be supported by all actors of the society to reach mutual gains. The idea of informal institutions is strictly connected to this concept. Furthermore, in the V4 – China context, there are multilateral institutions which are regulating the cooperation. EU, and world institutions combined with Chinese institutions are all influencing the multilateral level. European Parliament, European Commission, European Council, Court of Justice of the European Union, are the major institutions from a European perspective. Which are all regulating boundaries for the cooperation between China, and the V4 countries. Moreover, The United Nations, IMF, WTO, and other international institutions come also into play, alongside Chinese based institutions in the framework of China – V4 (Šimalčík, 2018). The major differences between the countries were found regarding the foreign policy strategy towards China.

## 6 Conclusion

This master thesis formulates with a plan to investigate the role of formal-, and informal institutions in the economic cooperation between China and the Visegrad 4 countries under the 17+1 platform. The goal was to be able to develop a comprehensive answer for the question by combining two International Relation theories, the Neoliberal Institutionalism by Robert Keohane, and the Impact of Institutions on Economic Performance by Douglass North. In order to be able to formulate a deep analysis, the four members of the Visegrad group have been analysed separately in a case study on a bilateral level. Furthermore, multilateral aspects of the cooperation have been included as well by describing approach from the sides on the 17+1 platform. By combining qualitative-, and quantitative data throughout the analysis, the empirical considerations have been supported by bilateral statistics about economic cooperation. All data have been viewed through the two IR theories to have a critical, analytical approach. On the basis of the presented case studies, and considered theories, this research now turns to answer the problem question: ***“How do formal- and informal institutions influence the economic cooperation between the Visegrád 4 and China under the 17+1 platform?”***

The answer for this question is as complicated as the nature of institutions. Regarding formal institutions, this research found several examples. When it comes to China, it was presented how the PRC created a multilateral institutional framework around the 17+1 platform. Within this formal institutional environment, they assigned high importance for supervision, credit line agreements, investment fund, trade promotion campaigns, infrastructure development, high-

level official meetings, and to promote Chinese organizations in engaging with CEE countries. Furthermore, the case studies, based on the analytical assumptions of North, showed that political-, economic-, and social institutions are operating on a bilateral level as well. In case of the Czech Republic, an official foreign policy strategy about cooperation with China has been established as a major political institution, furthermore several agreements and three memorandums have been signed to further develop an institutional framework. Hungary was the only country which lacks an official foreign policy strategy directly towards the PRC but China is a significant part of their Eastern Opening Policy. Furthermore, the country has signed a memorandum on cooperation, and friendly partnership agreements, supported by regular visits between high level Hungarian and Chinese officials. All these political institutions were set to regulate the bilateral cooperation and increase efficiency. On an economic level Hungary and China have established a deep institutional environment. A bilateral swap line agreement between major monetary institutions guarantees that Bank of China and the Asian Infrastructure Bank provides credit line agreements in the country from established branches. Moreover, other economic institutions include the “*China-CEEC Ministerial Meeting on Promoting Trade and Economic Cooperation, the China-Hungary Economic Joint Committee and its Working Group for Unimpeded Trade, and trade and investment promotion platforms such as the China International Import Expo and the China-CEEC Expo*” In case of Poland a direct Chinese foreign policy strategy “Go China” have been identified amongst, partnership agreements, memorandums, and the share of establishment of the Asian Infrastructure Bank. Slovakia showed to be the less institutionally developed amongst the V4, which also manifests in their lack of trade efficiency, however, an official foreign policy strategy: Strategy of Development of Economic Relations with China 2017-2020 is supported by agreements and memorandums. On a social level similar institution have been spotted in all four cases, in forms of cultural exchange programs, educational exchange, and Confucius institutes.

On one hand, in the economic cooperation between China and the V4 countries under the 17+1 platform, formal institutions lead to a more effective economic cooperation as the anarchic international environment is regulated, and institutions create order. In this formal institutional environment, the flow of information is much easier, both gathering and redistributing them, therefore all sides can reduce the level of uncertainty. Furthermore, the effective cooperation promoted by the formal institutions lead to higher gains, which by rational choice is the main goal of states in engaging in transnational cooperation. Formal institutions provide mental models which, in theory, are improving the quality of informal institutions.

On the other hand, informal institutions highly define the efficiency of formal institutions, and at this point the research completely agrees with the emphasizes North places on them. As the outcome of formal institutions are completely dependent on decisions by individual actors. Cultural heritage, social norms, are all controlling an individual's approach on common goals. In the case studies, this research highlighted, how corrupt actors in each country are. This high level of corruption will imply that actors will follow personal gains over common will. Furthermore, the lack of proper punishment supports the idea of personal gains as they by far exceed the level of retribution. Therefore, it can be concluded that informal institutions play a massive part in the efficiency of formal institutions and economic development. If both formal and informal institutions are functioning on the same high level, the environment they create will improve the quality of economic cooperation, thus creating economic development.

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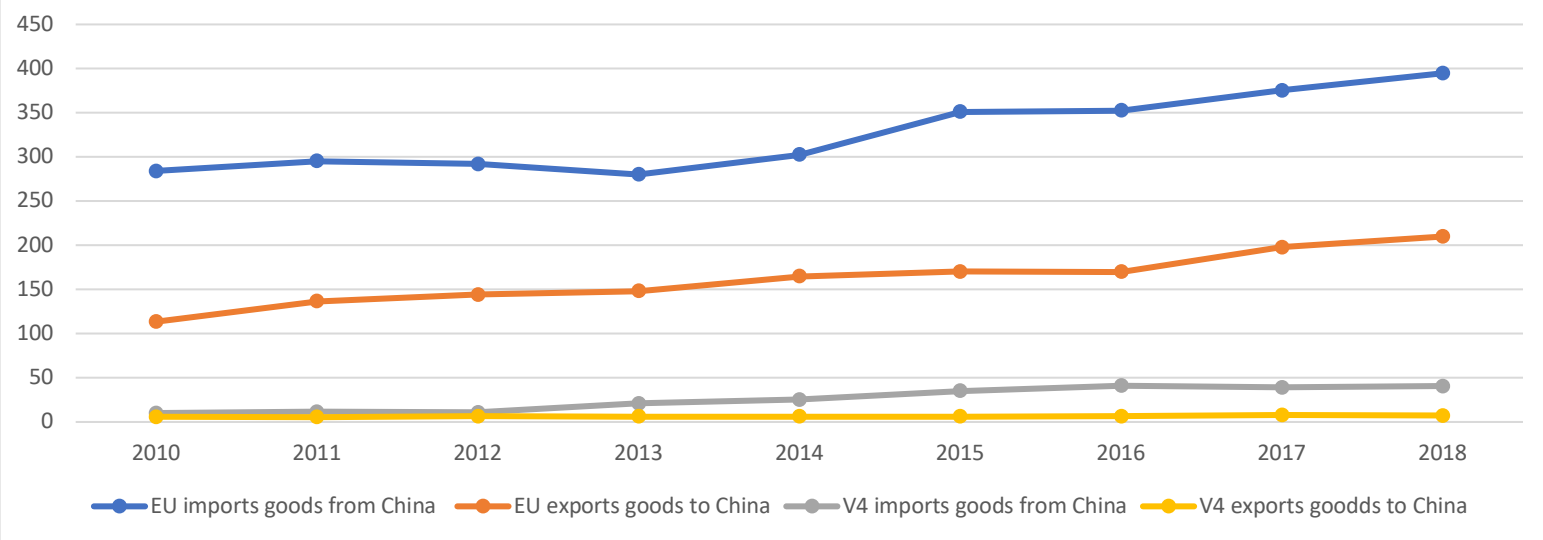
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## 8 Appendix

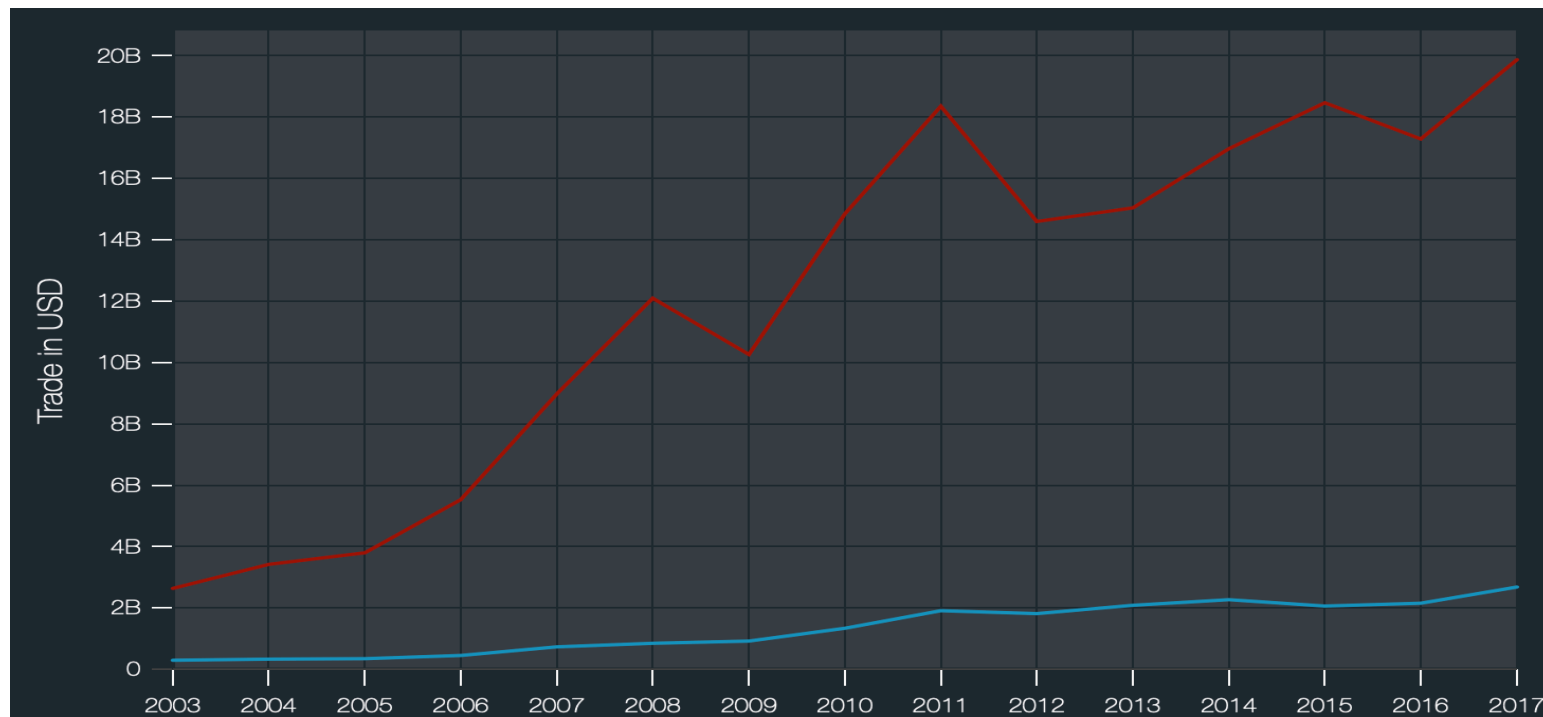
### 8.1 Appendix 1

Import and export rate in billions of Euro



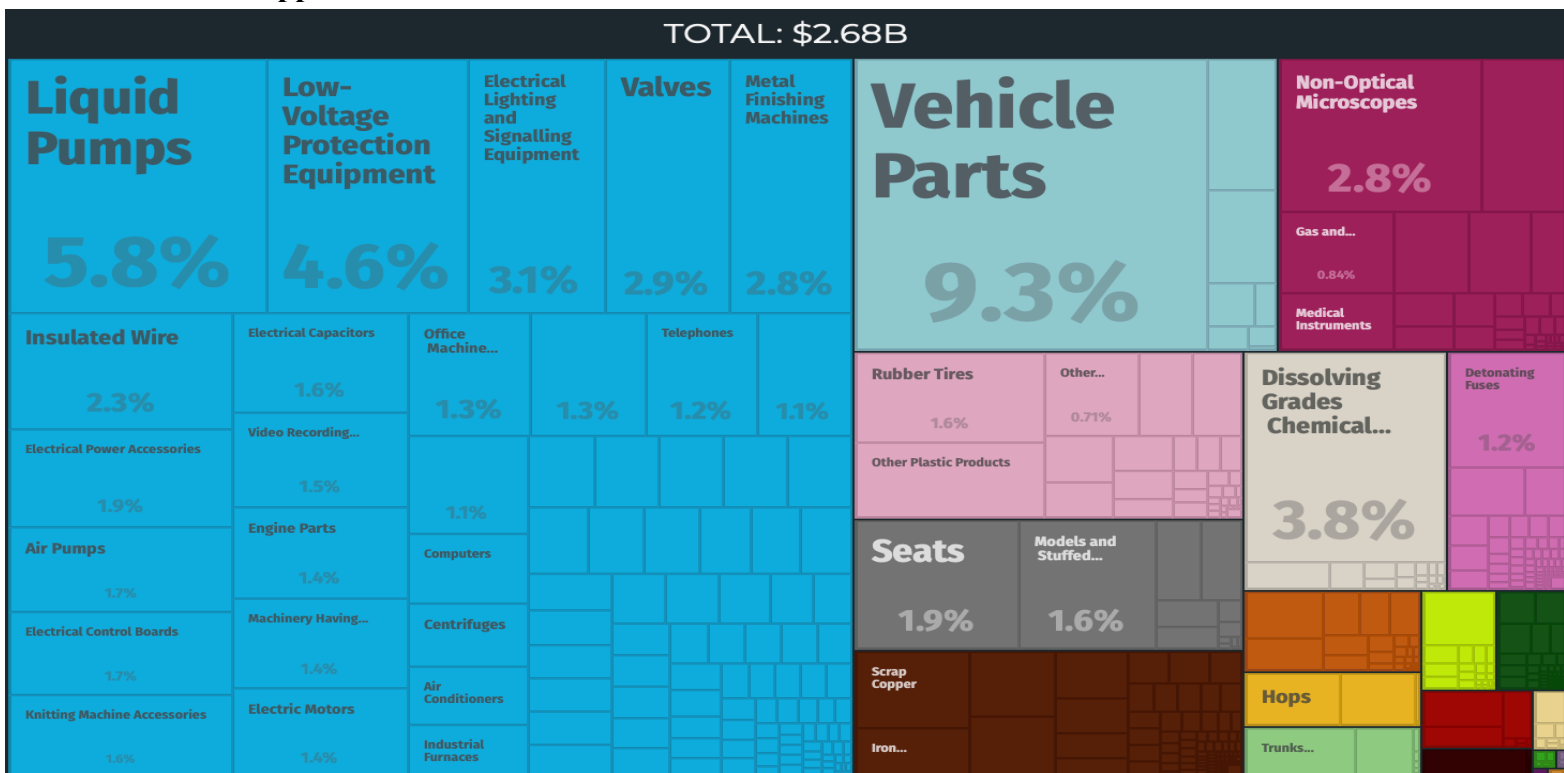
Individual collection of data, obtained from World Integrated Trade Solution and Eurostat

### 8.2 Appendix 2



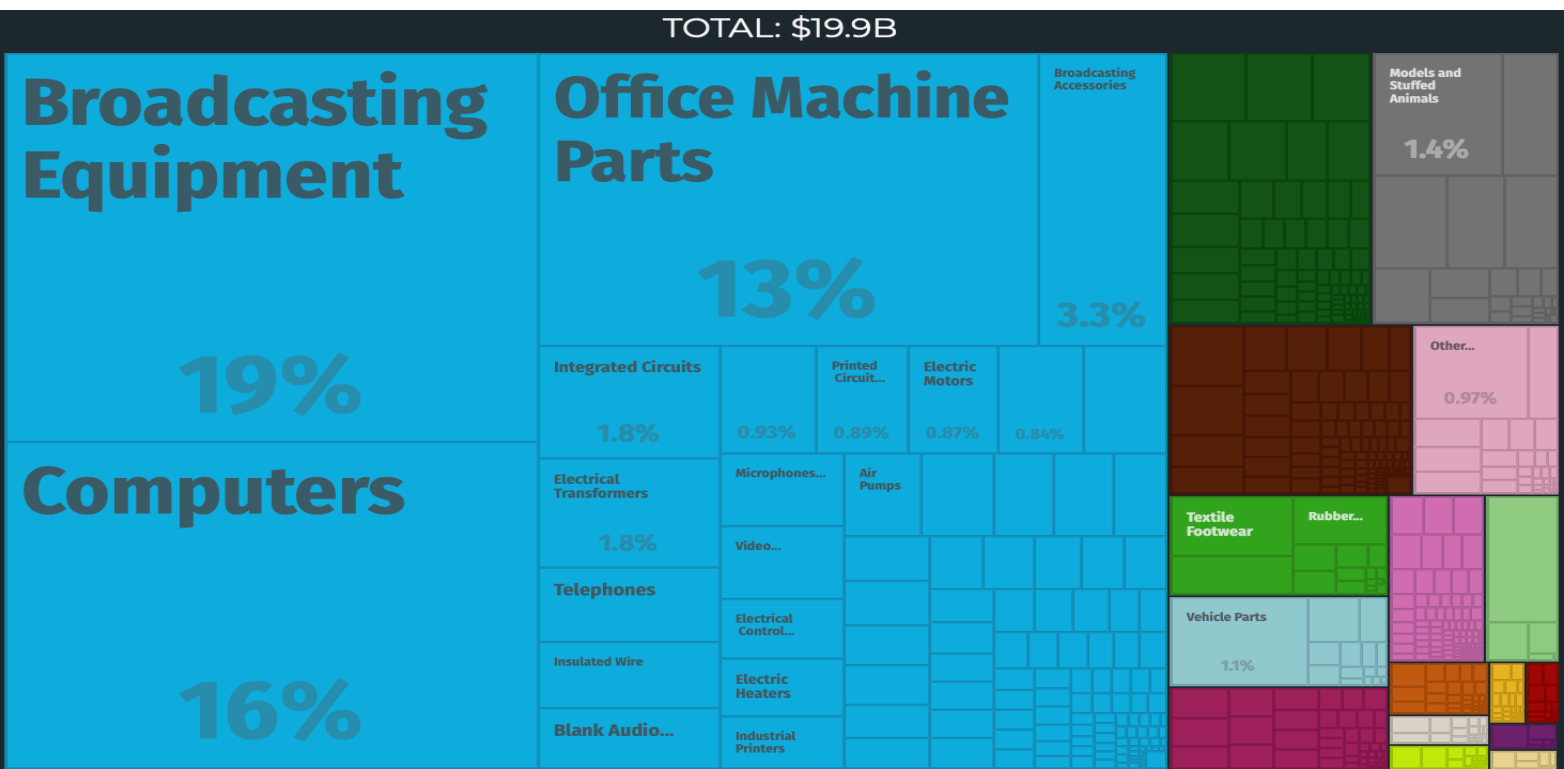
Czech import / export with China, the red line indicates imports, while the blue one stands for exports. (Observatory of Economic Complexity, 2020)

### 8.3 Appendix 3



Czech exports to China in 2017 (Observatory of Economic Complexity, 2020)

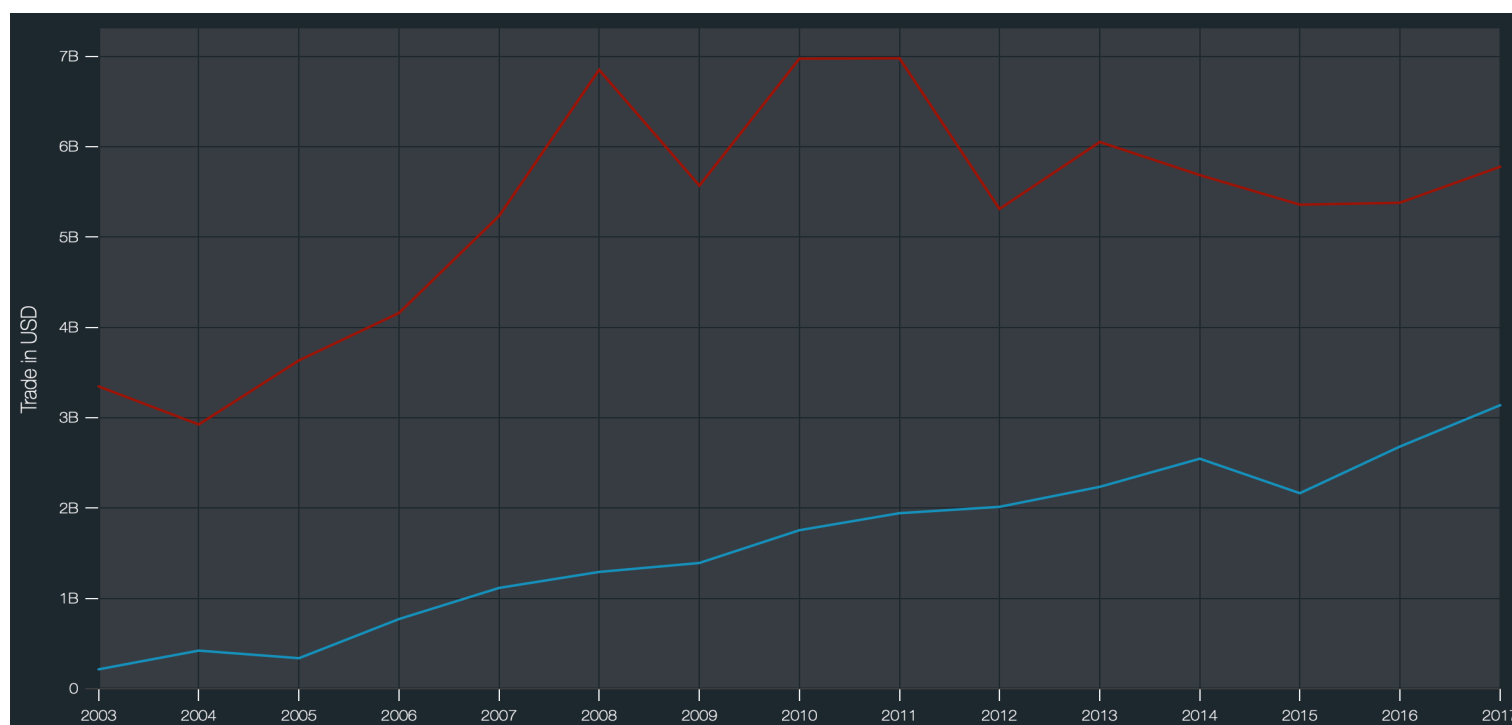
### 8.4 Appendix 4



Czech Imports from China 2017 (Observatori of Economic Complexity, 2020)

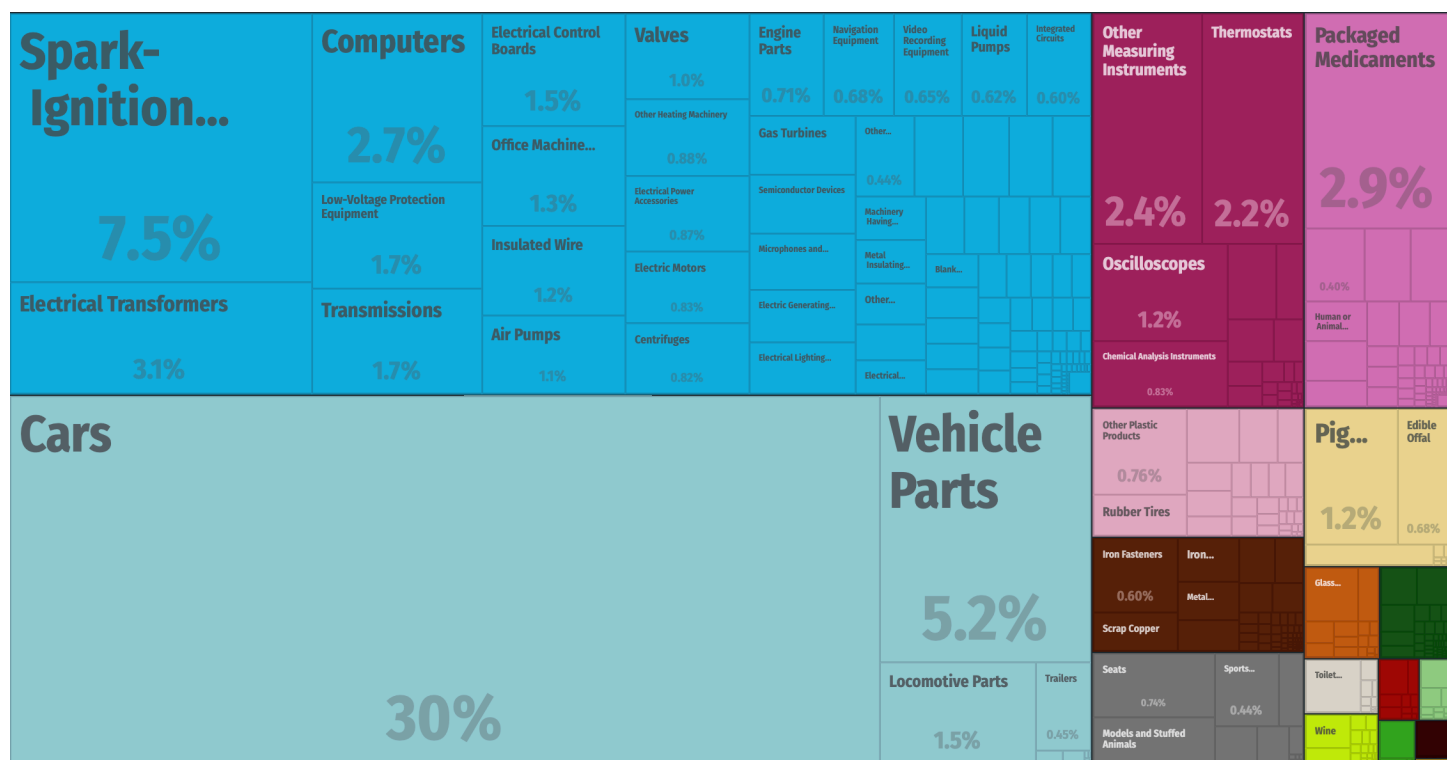


## 8.5 Appendix 5



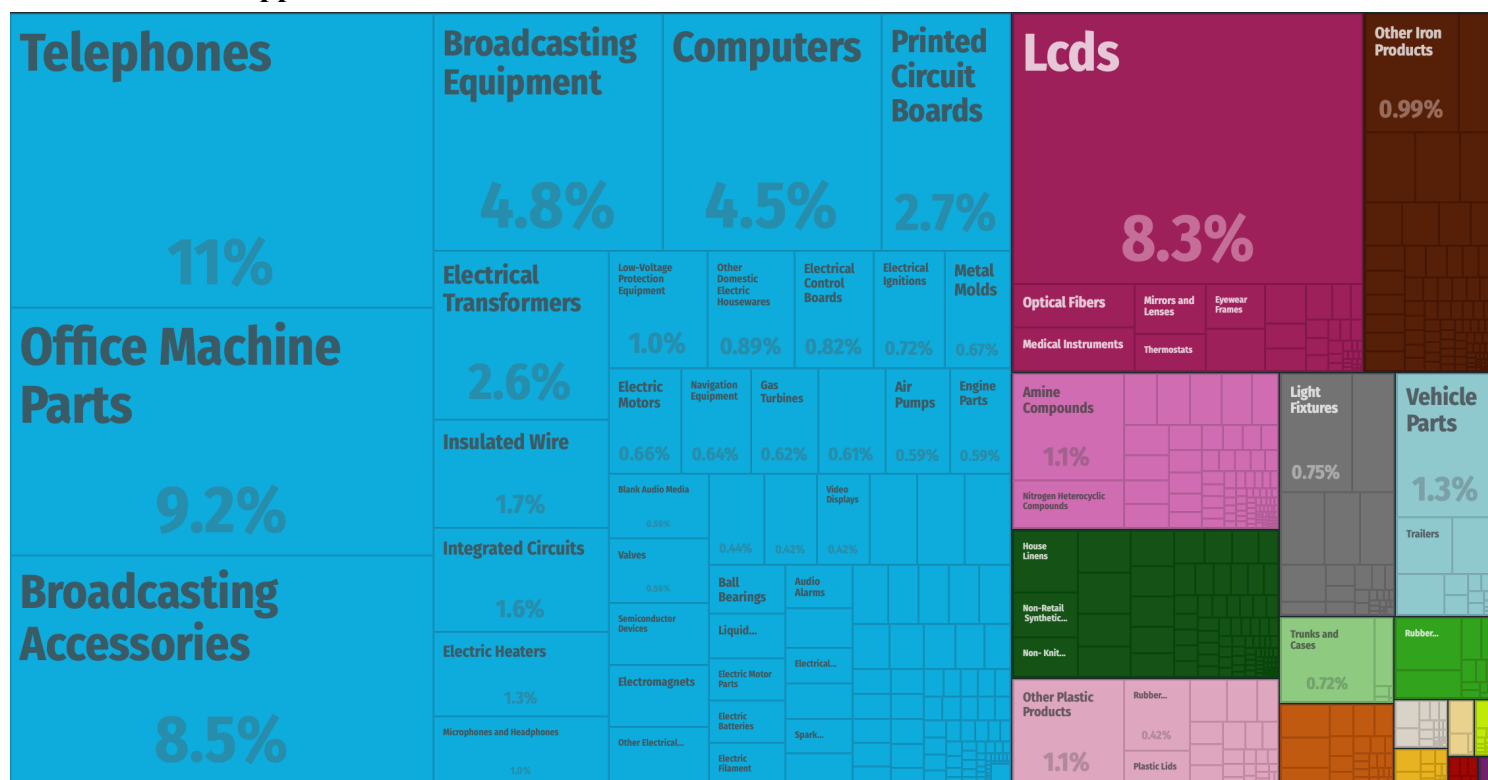
Hungary – China trade balance (Observatory of Economic Complexity, 2020)

## 8.6 Appendix 6



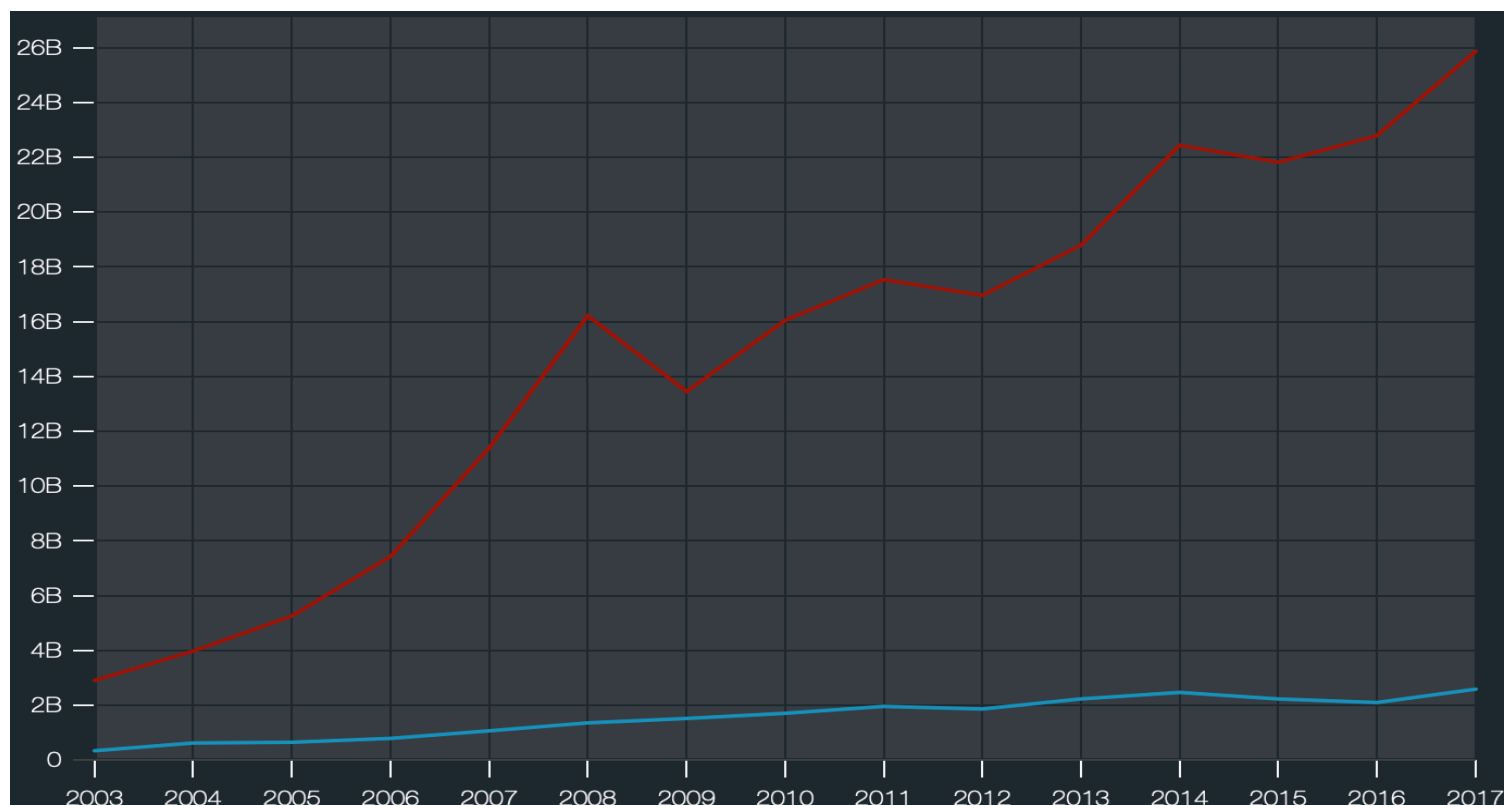
Hungarian export to China (Observatory of Economic Complexity, 2020)

## 8.7 Appendix 7



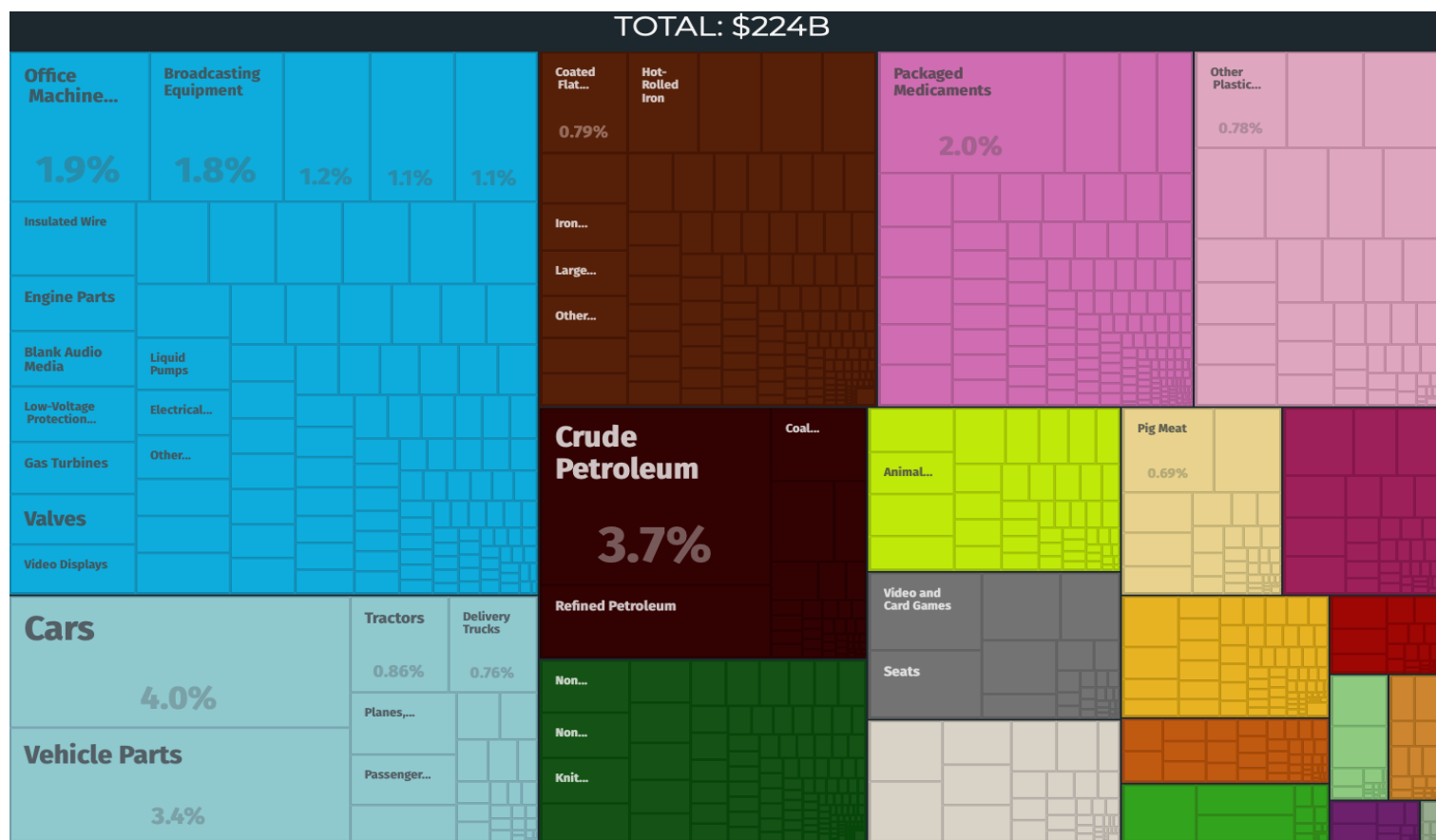
Hungarian import from China (Observatory of Economic Complexity, 2020)

## 8.8 Appendix 8



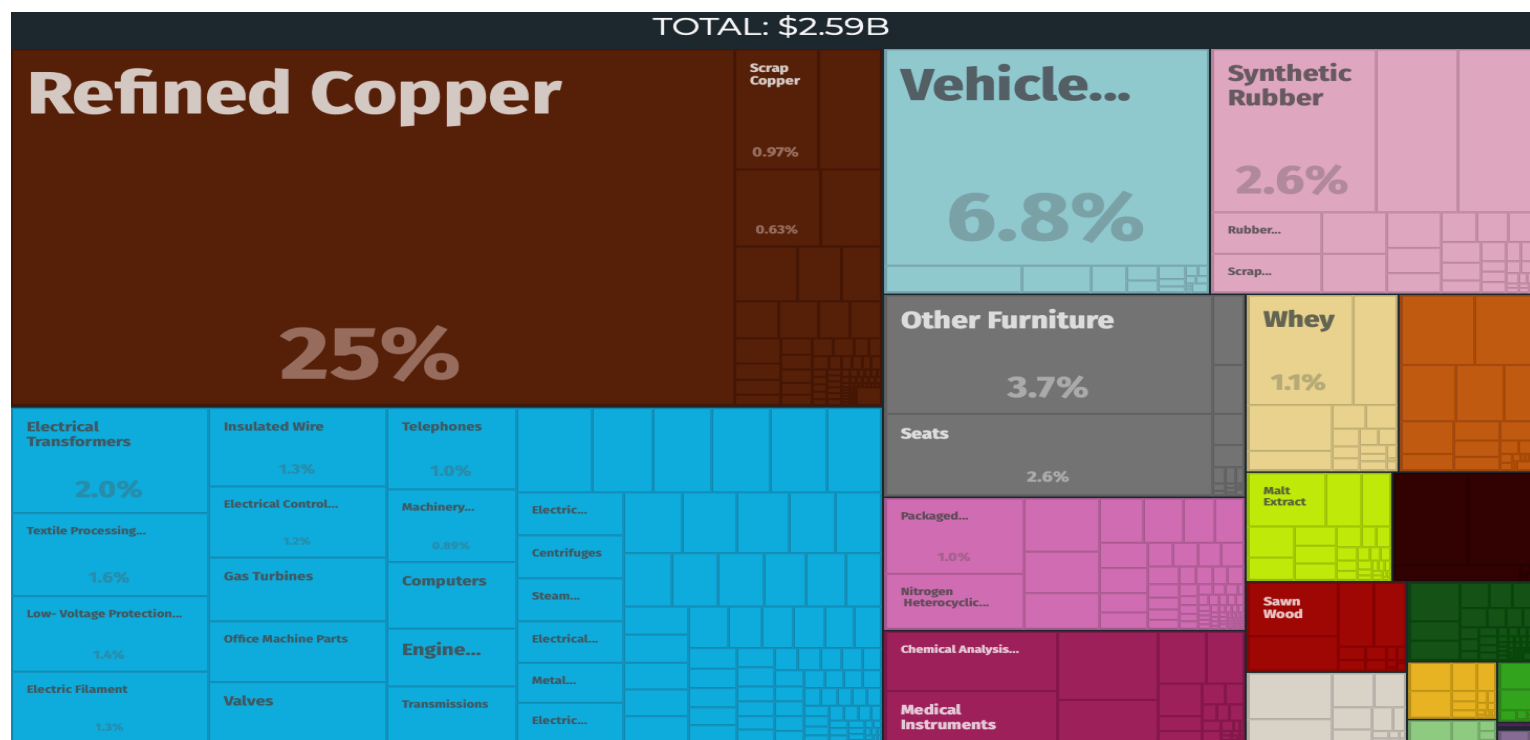
Polish-Chinese trade balance, red indicates imports, blue stands for exports (Observatory of Economic Complexity, 2020)

## 8.9 Appendix 9



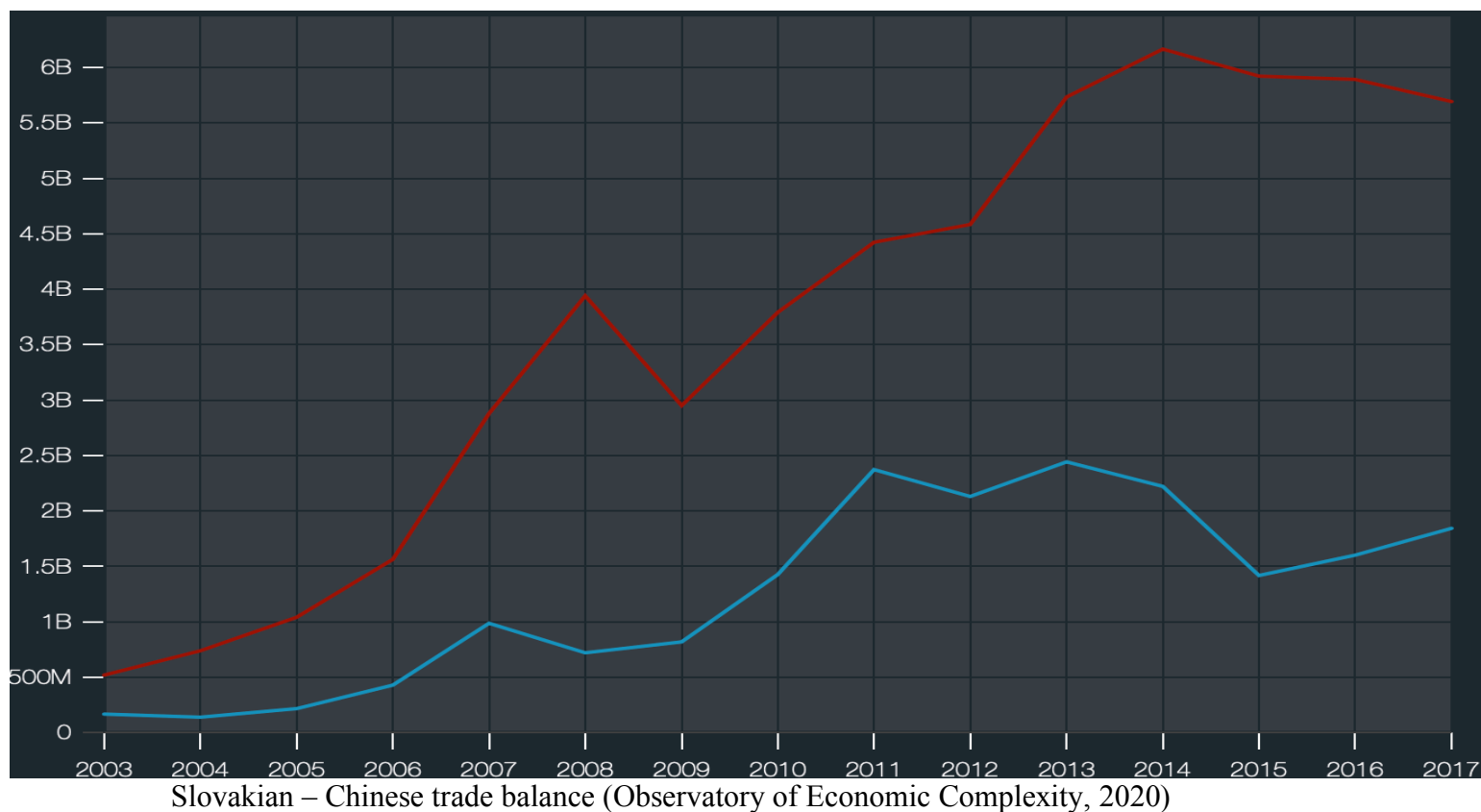
Polish import from China (Observatory of Economic Complexity, 2020)

## 8.10 Appendix 10

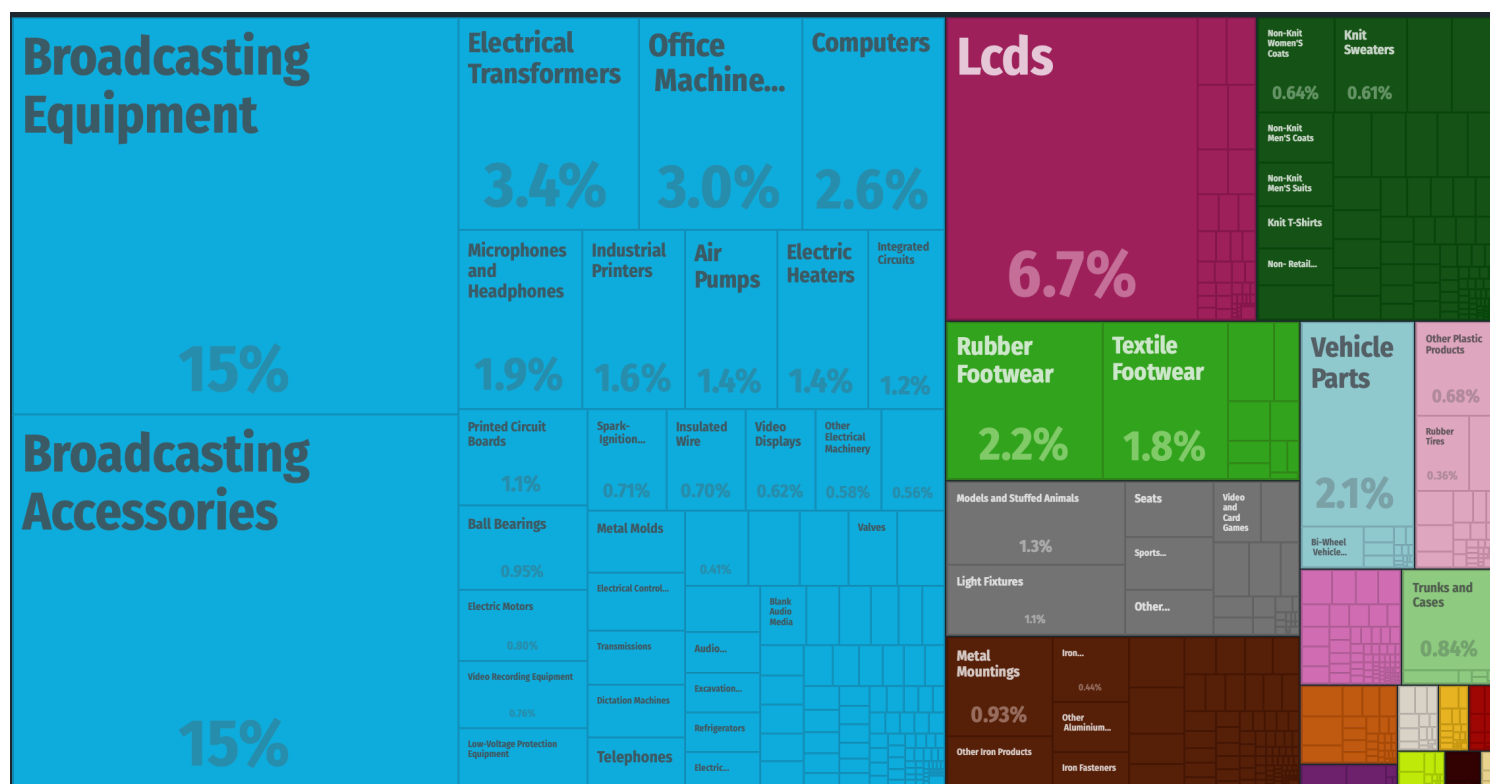


Polish exports to China (Observatory of Economic Complexity, 2020)

## 8.11 Appendix 11

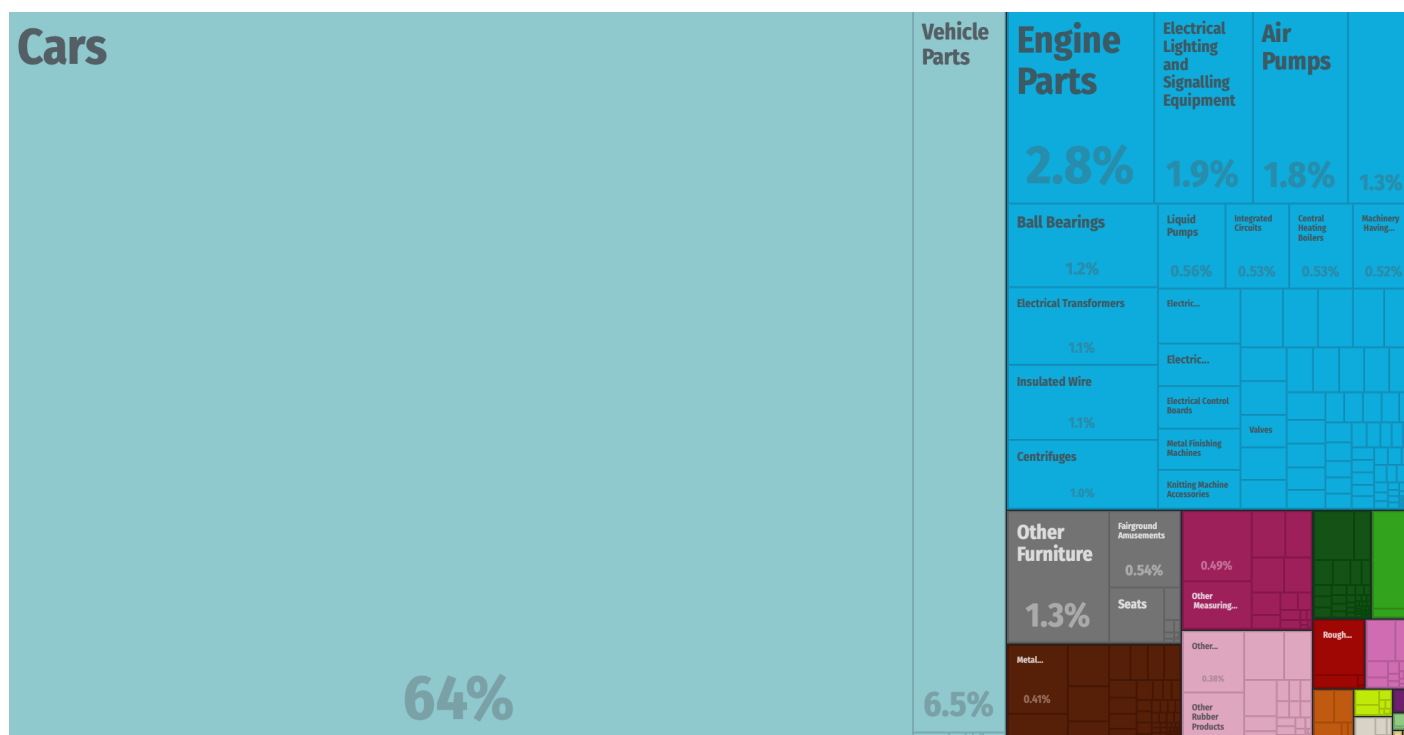


## 8.12 Appendix 12



Slovakian import from China (Observatory of Economic Complexity, 2020)

## 8.13 Appendix 13



Slovakian export to China (Observatory of Economic Complexity, 2020)