Hidden links

V4's final demand exposure toward the Chinese market

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Introduction

The Visegrad Four (V4) countries—Czechia, Hungary, Poland, and Slovakia—share several similarities in their economic and political relationships with China. While the fall of communism in Eastern Europe in 1989 saw a restoration of all four countries' formal ties with China, which were previously frozen due to the Sino-Soviet split during the Cold War, economic cooperation developed slowly in the 1990s and 2000s. However, this began to change in the aftermath of the Global Financial Crisis (GFC) of 2007-2008 and the multiple financial crises in the European Union in the early 2010s. Having imposed austerity measures while seeking to establish new sources of economic growth, all four V4 countries pivoted towards China in the hope that it could become a large export market for their products, thereby reducing their bilateral trade deficits and attracting foreign direct investment (FDI) in their economies.[1]

Deeper economic and political cooperation led to all four countries joining the 16+1 cooperation platform, a forum between Beijing and Central and Eastern European (CEE) countries, and the Belt and Road Initiative (BRI). However, the scale of trade and investment with China that the V4 states hoped would come from improved relations failed to materialize, leading to a sense of disillusionment in the region—except in Hungary, which has used its close relationship with China as a tool for extracting concession and benefits in intra-EU politics.[2]

However, another aspect that defines the V4 countries' relations with China is their economic structure, particularly the fact that their economies are deeply embedded within European supply chains. This impacts economic ties in two ways. First, because the four countries are primarily producers of intermediate goods, their exports to China are mainly indirect, forming component parts of final products that other European countries export to China. Thus, in order to understand the actual size of V4-China trade links, bilateral trade data needs to be replaced with an econometric analysis that traces the movement of economic value-added across borders. Second, there is limited potential for inward Chinese FDI into V4 states unless Chinese firms participate in the supply chain activity of European manufacturers. While this has not always been the case, seismic shifts in the automotive industry, engendered by the advances in electromobility, have resulted in a steep increase in Chinese investment in the CEE region.

This paper provides an in-depth analysis of the role of the V4's participation in European supply chains for goods that are exported to China by quantifying the actual value of exports to China, contrasting it with bilateral trade data, tracing the lack of this information in the decision-making and public discourse, and suggesting how its implications can inform policy-making.

Economic exposures and security implications in an interdependent world

This paper is part of a Central European Institute of Asian Studies (CEIAS) research series into states' exposure and dependencies on China. The first paper, "**The China factor: Economic exposures and security implications in an interdependent world**," illustrates the shortcomings of measuring trade relations solely on bilateral trade statistics. The paper argues that the final demand of the exported product, rather than bilateral trade, helps reveal the actual dependence on final consumption. This has important policy implications as the complex and interdependent nature of indirect trade exposure ties the hands of policymakers and reduces the scale and impact of tools that can be used to govern and mitigate the risks. China's coercion of Lithuania in 2021 and Central Eastern European (CEE) countries' indirect exposure to China via Germany's automobile industry demonstrate the risks that bilateral trade statistics may not reveal.

By introducing the concept of final demand exposure, together with a macro-level deep dive into 42 countries and case studies, the paper builds the case for including final demand exposure in policy discussions and measurements of economic dependencies, resilience, and risk estimations, as well as reviewing potential policy approaches and recommending those that could most effectively manage political and supply chain risks.

Czechia

Economic relations with China are highly politicized in Czechia. Initially, Sino-Czech relations were positive, following a familiar pattern as seen across the V4 that began in the aftermath of the Global Financial Crisis of 2007-2008 and the subsequent financial crises in the EU. Applying the politics of austerity and thus keen to expand trade and attract FDI from economies outside of the EU, Czech politicians turned to China, which had weathered the financial crises of the late 2000s better than most other countries.[3]

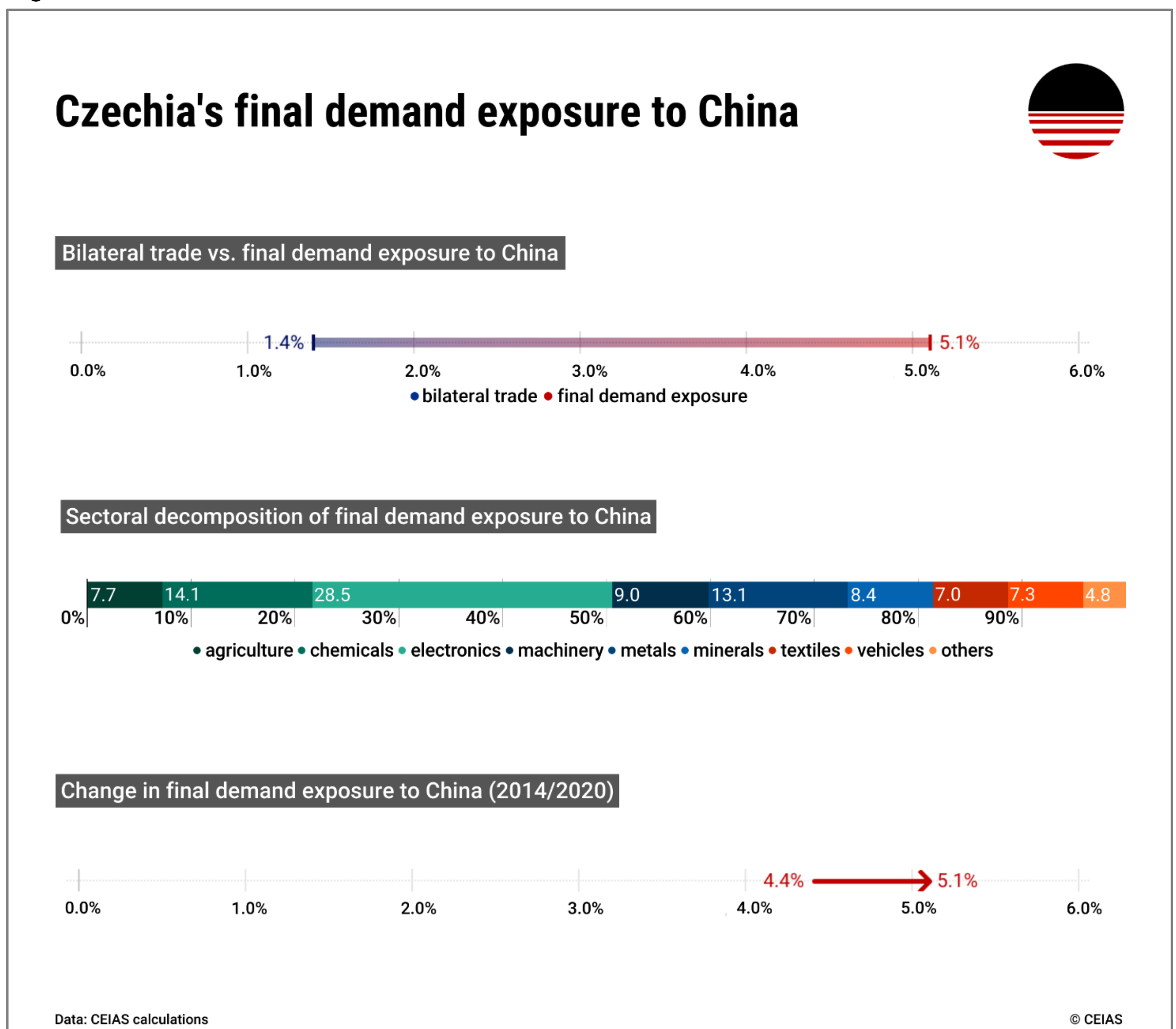
An increase in Czech diplomatic activity towards China was visible in the rhetoric and actions of most major political parties across the spectrum.[4] However, shortly after becoming president in 2013, Miloš Zeman became the main figure pushing for a closer Czech-Chinese cooperation. Zeman's actions, including multiple trips to China, culminated in Chinese President Xi Jinping's visit to Prague in 2016. The Czech-Chinese rapprochement was characterized by a lofty rhetoric about the potential economic benefits of closer cooperation, as expressed by both the Czech and Chinese politicians.[5] On the Chinese side, promises of increased trade and investment in CEE countries were a central tenet of the 16+1 format, which began in 2012, and which was later subsumed within Xi's grander geoeconomic project, the BRI.

Initially, improving economic relations with China made sense, at least in theory, as Czechia was pursuing austerity measures.[6] Moreover, China's ambitious trade and investment promises appeared achievable after a wave of investment in Czechia by CEFC China Energy (CEFC), a Chinese conglomerate. However, corruption investigations inside China led to the firm's bankruptcy in 2018, and its chairman, Ye Jianming, was imprisoned by the Chinese authorities on bribery charges. Ye was appointed as an advisor to Czech President Zeman in 2015. After CEFC's collapse, no large-scale investment project was announced by a Chinese company in Czechia, while existing projects were perceived as low quality because they were mainly mergers and acquisitions (M&As) instead of greenfield investments—a form of FDI where the parent company starts a new venture in a foreign country by constructing new operational facilities from the

ground up—which are preferred by Czech politicians, economists, and the broader public.[7] Additionally, although trade with China grew during the 2010s, with exports doubling in a decade, Czechia's trade deficit with China also doubled as the dependence on imports grew steadily.

The disparity between Chinese economic promises and what materialized, coupled with Beijing's more assertive stance in the international arena and developments in domestic Czech politics by the late 2010s, turned Czech-Chinese relations into an object of domestic political competition and division.[8] While those debates involve multiple facets of Czech-Chinese relations—from human rights to security to public health—this paper focuses on the economic arguments. A further characteristic of the debate is that comparisons and juxtapositions are made with Czechia's engagement with Taiwan,[9] which is also explored in this paper, although it does not provide data about Czechia's final demand exposure with Taiwan.

Figure 1



Czechia's bilateral trade with China grew steadily until the outbreak of the COVID-19 pandemic. Although Czechia's exports to China increased in both absolute and relative terms, it was met with unease by Czech politicians, academics, think tanks, and media organizations.[10] In part, this is probably because China accounts for only a small percentage of Czechia's overall exports—between 1.3% and 1.5%—which leads to a common conclusion that China is not a significant export partner.[11]

However, from the perspective of value chains, Czechia's exports to China are much higher than bilateral trade statistics indicate, as a higher number of intermediate goods are eventually sold to China by other countries. Analysis conducted by CEIAS indicates that this can be as much as 5% of Czechia's overall exports.[12] On the other hand, value-added imports from China are lower in value than bilateral import statistics suggest. While it is not within the scope of this study, similar econometric analyses have revealed that a portion of Chinese exports consists of intermediate goods that are further exported to other countries.[13] This also aligns with the structure of the Czech economy, which is embedded within European supply chains. Higher value-added exports to China—via third countries—and lower value-added imports from China—due to their further resale abroad— suggest that Czechia has a significantly smaller trade deficit with China than is usually assumed.

As China is the final destination for 5% of Czech exports—directly and indirectly—it ranks much higher in the table of top Czech export partners compared to when only bilateral trade is considered, significantly changing the narrative on Czechia's economic relations with China and, by extension, China's economic performance in Czechia.

The difference between only counting directly exported goods to China (1.4% of Czechia's overall exports) and the inclusion of intermediate goods (bringing it up to around 5%) is one of the largest differences of any EU state. This should not come as a surprise due to Czechia's geographic proximity and deep links with the German economy; some 31% of Czechia's bilateral exports are purchased by Germany).

However, it gives rise to several considerations. First, because of the German economy's structural dependency on China, the Czech economy is also highly dependent on the demand from China. This, in turn, means that Czech exports are exposed to both the domestic performance of the Chinese economy and the state of relations between Germany—and the EU—and China.

Second, Chinese demand for imports from Europe sustains a large number of jobs in Czech export-oriented industries. According to Eurostat, more than 16% of all Czech jobs are created by the final demand for products from outside the EU, including China.[14] As such, a fall in Chinese demand would result in a rise in unemployment in Czechia. Third, the fact that Czechia is very closely enmeshed with Germany's economy, coupled with a rather low level of production diversification (concentrated in the automotive industry), exacerbates Czechia's exposure to global economic volatility, while also limiting Prague's ability to respond effectively to sudden changes and address potential risks.

One such global change is the rapid growth of Chinese electric vehicle (EV) manufacturers, which are seizing a larger portion of the global market share. This leads to a decrease in demand for Czech exports, as the Czech automotive industry loses market share directly or indirectly via its interdependence with the German car manufacturers. It could also result in more Czech imports from China, exacerbating Czechia's trade deficit with China.

However, there is also the possibility that Chinese EV and battery producers could move their supply chains to Czechia. This would be an interesting turn in the economic relationship and lead to a higher Chinese FDI in the country, an increase in Czech GDP and exports, and the emergence of new security considerations, given that automobile manufacturing is a strategic sector of the Czech economy. However, while a number of Chinese EV producers are establishing subsidiaries in the other three V4 countries, Czechia has so far not received any such deals.[15] This might be because Czechia has higher rates of tax, higher cost of production, as well as having a lack of established partnerships with local producers and subsidies, or simply because of the political climate in Czechia, which is decidedly anti-Beijing.

Hungary

Hungary stands out in the V4 region as the country with the closest political and economic relations with China. In part, this is because of the Global Financial Crisis, which had an enormously detrimental impact on the Hungarian economy and led Budapest to apply for international financial assistance. A bailout package of US$25.1 billion was provided by the International Monetary Fund (IMF), the EU, and the World Bank in return for the Hungarian government imposing austerity measures, including radical welfare spending cuts and tax increases. As Hungary's financial malaise worsened, an economic crisis became a full-blown political crisis. In March 2009, Prime Minister Ferenc Gyurcsány was replaced by Gordon Bajnai, a young entrepreneur, as head of a semi-technocratic government. Bajnai's government pursued a new set of austerity measures to regain the trust of international financial institutions and foreign investors. While these efforts "managed to bring down the budget deficit, they failed to convince the Hungarian electorate".[16]

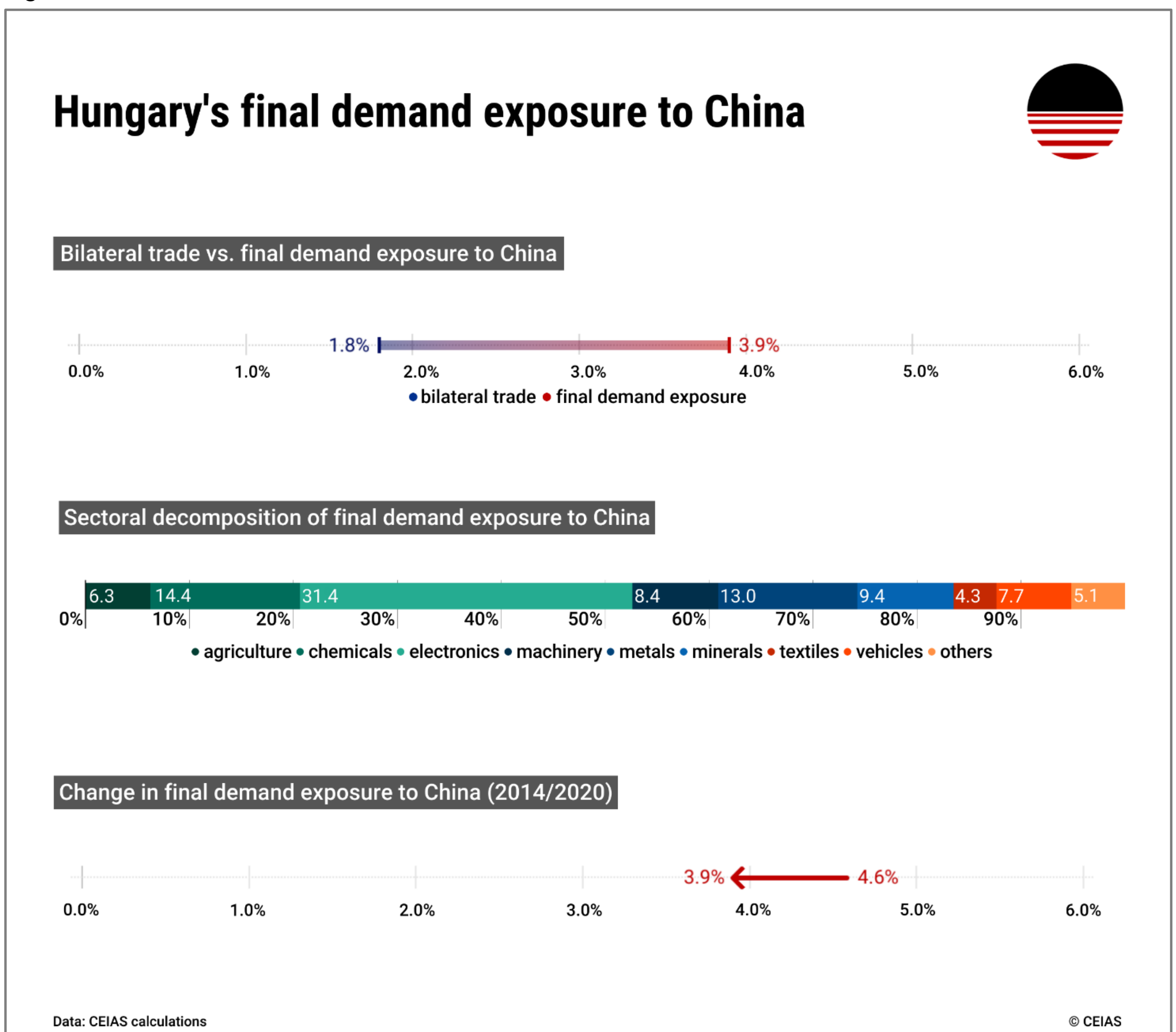
Viktor Orbán, whose Fidesz party won the 2010 general election, campaigned against the austerity policies. Once in power, his government pursued policies that nominally contradicted the country's previous neoliberal and pro-Western course. For instance, in a much-debated move, it left the negotiations on renewing a standby loan with the IMF in July 2010. Although the move led to a depreciation of the *forint* and eventually to Hungarian bonds being downgraded to "junk" status,[17] Orbán stood firm, proclaiming that Hungary "would not accept diktats" from the IMF and the EU in the future, claiming that they are "not our bosses."[18]

At the same time, he reoriented Hungary's economic foreign policy to countries outside of the West, such as Russia, China, and the Middle East. In 2009, during the bailout negotiations with the IMF, Orbán deepened relations with China. This came as a surprise to some because Orban was previously supportive of Tibet, having met the Dalai Lama in 2000. [19] Shortly after winning the 2010 elections and becoming prime minister of his country, however, Orbán made an official visit to Beijing. This was reciprocated by China in 2011 when Prime Minister Wen Jiabao visited Budapest to mark the creation of the 16+1 cooperation platform.

Orbán's government launched the so-called Eastern Opening Policy in 2011. While the policy has never been clearly articulated as a strategy, the reading of government statements suggests that its goal was to boost Hungarian exports outside of Europe and increase FDI inflow into the country.[20]

A number of projects were launched under the auspices of the Eastern Opening Policy, including Hungary's issuance of CNY-denominated bonds and CNY swap facility; infrastructure projects such as the construction of the Budapest-Belgrade railway; the establishment of Fudan University European campus in Budapest; and several other projects aimed at facilitating Chinese FDI in Hungary. As a result, Hungary has long been the largest recipient of Chinese FDI among the V4 states.[21] It is important to note factors other than direct government support play a role in attracting

Figure 2



Chinese investment, including the lowest corporate tax rate in the V4 region—a reason why Hungary is also a top destination of Taiwanese FDI[22]—the existing structure of the economy, geographical linkages, and human talent.[23]

However, while Hungarian exports to China have steadily increased, Chinese exports to Hungary have increased even faster, leading to a growing trade deficit. Moreover, although Hungary's exports to China have grown nominally, they have remained stable as a percentage of its overall exports. Indeed, China accounted for 2.5% of Hungarian exports in 2017 (the peak) but it has since fallen to approximately 2% in 2020.[24]

An even more surprising development can be observed in indirect trade. Similar to its neighbors, Hungary is deeply embedded in Central Europe's supply chain network, largely because of its large automotive industry, which is dominated by German car manufacturers. Indirect exports to China are more than twice as large as direct exports, accounting for around 3.9% of Hungary's overall exports. This is not insignificant, yet it is a considerably smaller percentage than for Czechia and Slovakia, both of which also have highly developed automotive sectors. Even more surprising, Hungary's indirect exports to China decreased between 2014 and 2020, dropping from 4.6% to 3.9%. This is in line with Hungary's slight decline in direct exports to China. However, it stands in contrast with the developments in other countries in the region, which have seen a steady increase in indirect exports to China. Hungary's situation can be attributed to the fact that most of the cars produced by Hungary's automotive industry are for the European market and it builds a smaller proportion of SUVs, a major category for European car exports to China, than its neighbors.

Economic relations between the two countries began to change significantly in the early 2020s. While geopolitical events, such as the COVID-19 pandemic and Russia's invasion of Ukraine, have brought Hungary and China closer together on the political level, economic relations remain shaped by the rise of the Chinese manufacturers of electric batteries and EVs. As a result, Chinese investment in Hungary has increased significantly, defying claims made by some quarters that China was economically insignificant to Hungary.[25] Hungary has become one of the top destinations for Chinese EV companies, such as CATL and Nio, which have announced record-breaking investment deals in the country, worth €7.3 billion and €15 million, respectively).[26]

However, almost all recent Chinese FDI in Hungary has come from private firms. In the decade following the GFC, Chinese FDI was relatively low,[27]

which in turn meant there was little incentive for other Chinese firms to establish operations in the region. Encouragement from the Chinese government did not trump the economic reality faced by Chinese firms. Nowadays, while China’s growing EV industry has invested significant amounts in Hungary, trade relations will likely go in the opposite direction. The new EV factories will require more imports from China while their products will be sold to European markets. Therefore, imports from China will increase and exports to China will further drop, resulting in an even larger trade deficit. It is important to note that it will have a net positive effect on the Hungarian economy due to an increase in domestic manufacturing. However, the trade relationship with China will become even more imbalanced.

Looking at it from a risk perspective, Hungary will reduce its demand dependence on China but significantly increase its supply dependence. Hungary might not face direct political risks from China due to the two countries' cordial relations, but there might be other risks, such as production bottlenecks.

NOVOTEL
BREITLING
LG OLED TV

Poland

Just like all other CEE countries, Polish relations with China started to improve significantly in the aftermath of the GFC in 2008. However, unlike its neighbors, which were more proactive in improving their relations with China, Warsaw and Beijing have improved relations on a more equal footing. At the Shanghai Expo in 2010, for instance, the Polish pavilion was given a prestigious location, and the Marshal of the Sejm was invited to deliver closing remarks along with the Chinese Prime Minister Wen Jiabao and the United Nations General Secretary Ban Ki-moon. In a subsequent meeting between the Polish President Bronisław Komorowski and Chinese President Hu Jintao in Beijing, the two heads of state agreed on elevating the relations into a strategic partnership. The number of Sino-Polish official visits doubled, and eight cooperation frameworks were signed between 2010 and 2014.[28]

Poland has joined the BRI and the 16+1 cooperation framework Indeed, the first 16+1 summit was held in Warsaw in 2012. Despite the recent setback caused by a Chinese company abruptly abandoning the construction of a Polish highway,[29] Warsaw has been enthusiastic about the prospect of increased trade and investment cooperation between the two countries. The issue of connectivity has been high on the Polish agenda. Poland has long positioned itself as a main overland corridor for goods transport in Europe, particularly by train. Additionally, Poland has sought to find synergies and commonalities between its own Three Seas Initiative, which aims at enhancing connectivity in the Baltic, Adriatic, and Black Seas regions, and China's vast connectivity projects.

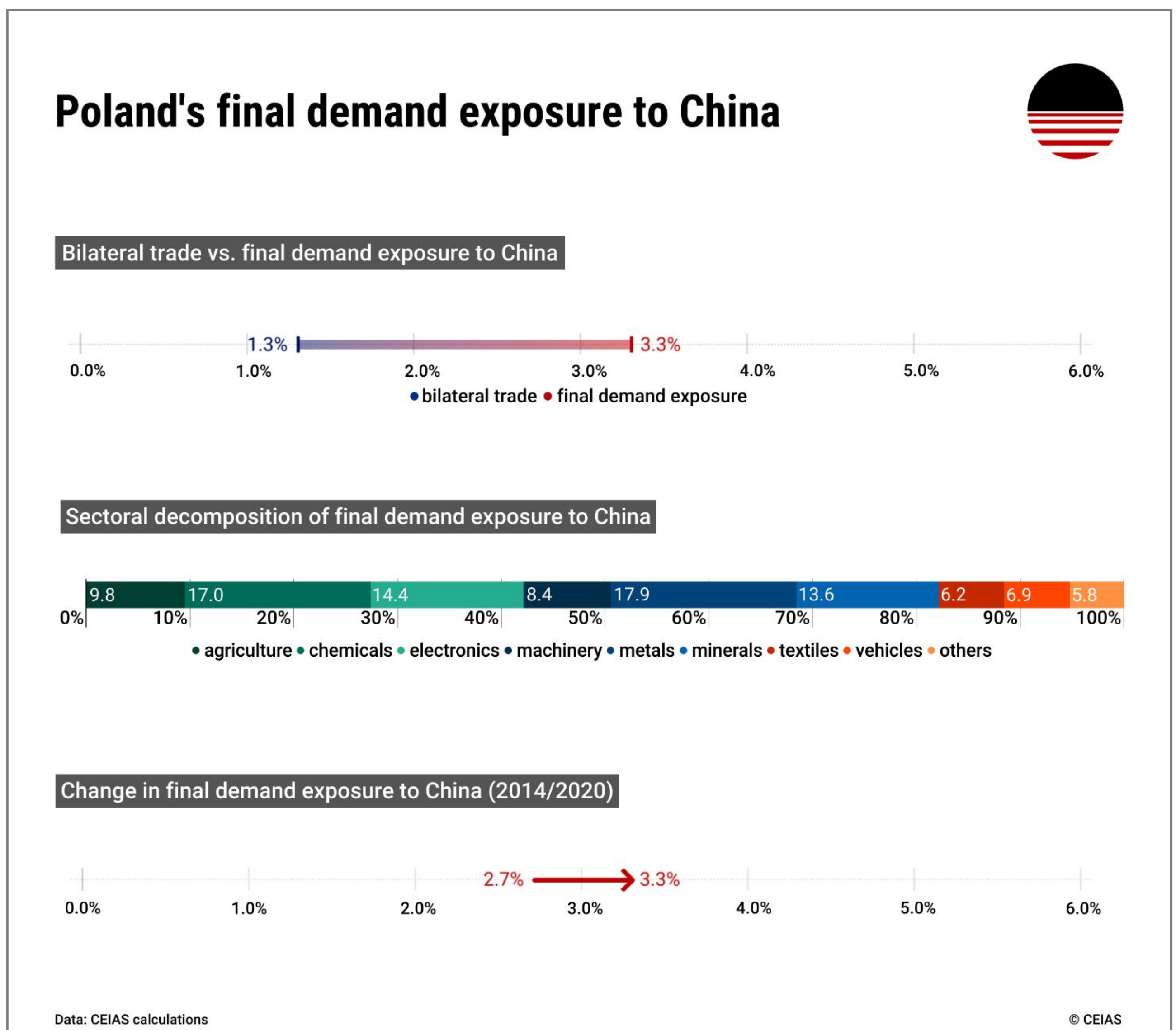
While Polish exports to China grew after the establishment of the 16+1 framework, they were outpaced by imports from China, resulting in a widening trade deficit, much to the dismay of Polish government officials.[30] Similarly, the amount of Chinese investment in Poland has fallen short of expectations; just US$2.4 billion, as of 2020.[31] Polish exporters, particularly those in the agricultural sector, have found it hard to enter the Chinese market. Their frustration has been relayed to Beijing by Poland's leaders.[32]

Despite the mismatch between the economic reality and expectations, the Polish government remains cautiously optimistic about the further potential of relations with China. In October 2021, the Ministry of Finance issued CNY-

denominated Panda bonds.[33] In February 2022, Polish President Andrej Duda was the highest-ranking representative of a Western government to attend the Winter Olympic Games in Beijing.[34] At the same time, however, Poland was not keen to proceed at the pace proposed by Germany and France over the EU's Comprehensive Agreement on Investment (CAI) with China and it called for engagement with the US on this matter.[35]

The Sino-Polish relations have soured in the aftermath of the Russian invasion of Ukraine, principally because the Polish government perceives China as supporting Moscow. As early as 2014, Warsaw had expressed its dissatisfaction with China's position on Ukraine.[36] The Polish government,

Figure 3



a major supporter of Ukraine, has made it clear that it equates China's proclaimed neutrality with support for Russia. When Li Hui, the Special Envoy of the Chinese Government for Eurasian Affairs, toured Europe in March 2023, the Polish foreign ministry issued a communique that expressed concerns about Beijing's efforts to strengthen its relations with Russia.[37]

he war in Ukraine has reduced rail transport from China to Europe, denting what is arguably the most successful facet of Sino-Polish economic engagement. Furthermore, the war has revealed Poland's dependence on several critical materials, from pharmaceuticals to machinery.[38] Perhaps the most pronounced, however, is its dependence on its own automotive industry. According to official statistics, China accounts for just 1.3% of all of Poland's exports, a source of frustration for Polish officials, as described above. However, indirect exports to China amount to 3.3% of all exports. This is because Poland exports a number of intermediate goods to other European states, which are further processed and re-exported to China. The size of Poland's indirect trade with China—information of which has been made publicly available by, among others, the Polish Economic Institute[39]—has barely entered public discourse. While it does shed some light on the trajectory of Poland's exports to China, it is debatable whether it will change the narrative within Poland about China.

Yet, the indirect trade data also demonstrates the Polish automotive industry's dependence on Chinese demand. As previous sections made clear, structural changes brought about by the rise of Chinese EV production can adversely affect the established automotive players. This will be felt indirectly in Poland by way of decreasing orders from German and other automotive producers. On the other hand, Poland has also seen an increase in FDI in its own EV manufacturing sector, with a bulk of the investment coming from Chinese firms.[40] Poland's well-developed automotive and industrial machinery sectors are also well-positioned to benefit from the transition from internal combustion engines to EVs. However, tensions in EU-China relations and potential regulatory setbacks, such as increased investment scrutiny, might divert Chinese investors away from Poland.

Slovakia

In the early 2010s, Slovak governments were open to the prospect of increasing trade and investment cooperation with China. Ties peaked after Robert Fico became prime minister in 2012 and prioritized the development of relations. Under his watch, Slovakia joined both the 16+1 forum and the BRIs. However, Fico was also the first high-level politician from the CEE region to voice discontent with China promising investment but not delivering. For this reason, he was the only head of state or government from CEE to skip the 16+1 forum in Suzhou in 2015, sending a lower-ranking minister in his place.[41]

Nevertheless, Fico remained committed to maintaining close relations with China, and multiple members of his government visited China. Even after Fico's government was replaced by more pro-EU and pro-NATO-oriented parties, Slovakia sought to maintain a good working relationship with China. However, the intensity of official exchanges dropped significantly due to the COVID-19 pandemic.

Slovak-China relations were not without friction. Beijing was strongly critical after Slovak President Andrej Kiska met with the Dalai Lama in 2016, although that meeting had no real impact on economic relations.[42] In 2021, Prime Minister Igor Matovič expressed a long-held objection to Chinese certification of agricultural products. The slow pace at which the Chinese authorities issued licenses for agricultural imports is considered a tool for Beijing to extract concessions and unfairly protect its markets from imports.[43]

Slovakia has also sought to improve its relations with Taiwan. Bratislava seeks to nurture economic ties with both entities—the People's Republic of China (PRC) and the Republic of China (ROC)—but it must play a careful balancing act. By not making grand statements or rhetorical nods to both parties' competing interests, Slovakia has so far been successful in improving relations with Taiwan without aggravating China.[44]

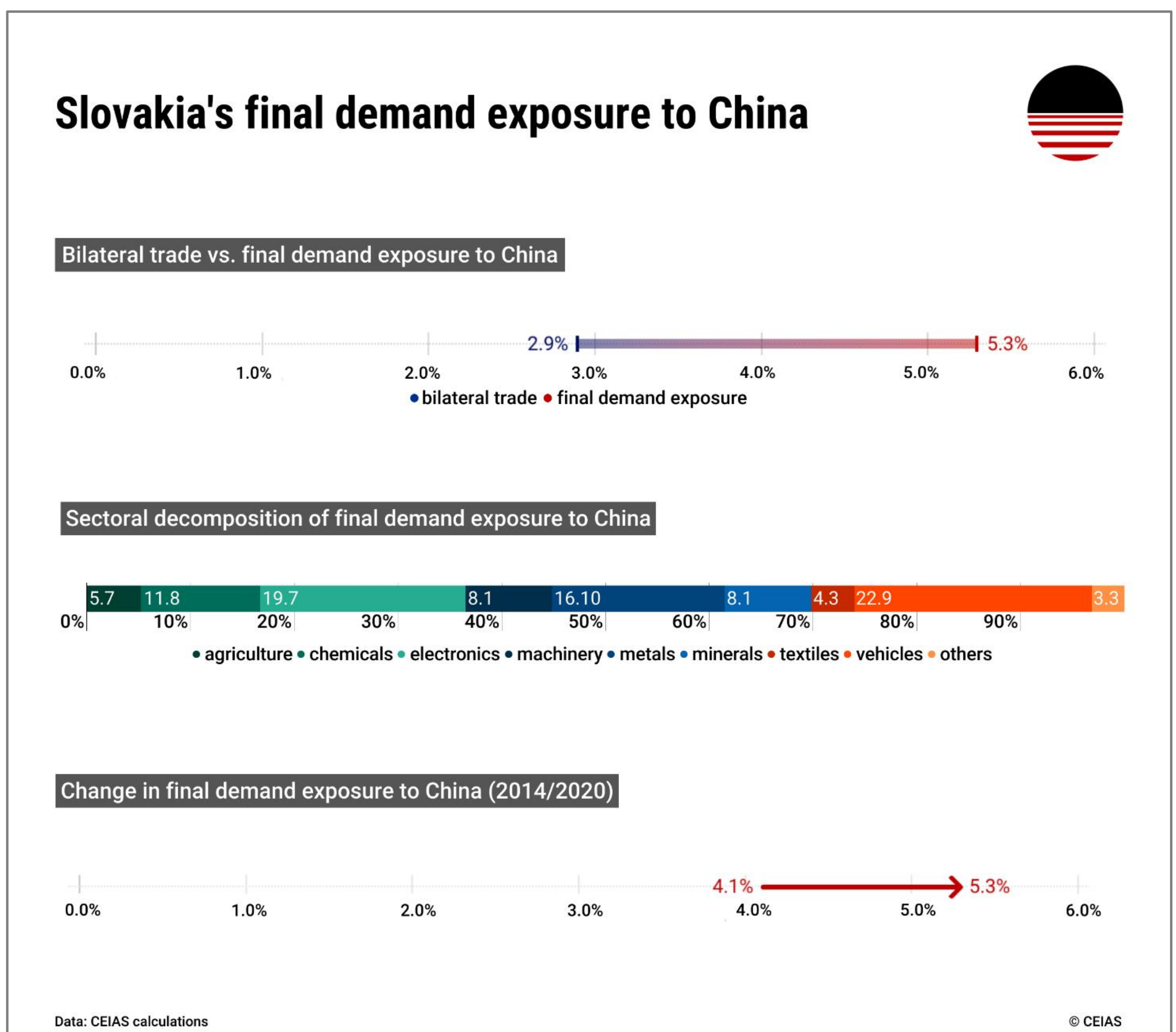
Slovakia is unique among the V4 states in that it has a significant proportion of direct exports to China, concentrated in the exports of vehicles and machinery, which account for more than 3% of Slovakia's overall export value, among the highest in Europe. Furthermore, direct exports are

concentrated within the automotive sector (which accounts for 75% of exports to China), with a single firm, Volkswagen Slovakia, selling 25% of the country's total exports, predominantly SUVs, to China.[45]

There is also a significant proportion of indirect trade between Slovakia and China, a result of its deep embeddedness within European supply chains. In fact, Slovakia's combined (direct and indirect) trade exposure to China is the highest among the V4 countries, at 5.3%. Just as direct exports, indirect exports are also concentrated in the car manufacturing and machinery sectors.[46]

China is not a highly contested topic in Slovakia's political discourse, even though clear divisions exist between its political parties. These divisions are more pronounced in the areas of diplomacy and security. However, in the

Figure 4



economic sphere, the difference is often muted for a number of reasons, chiefly because of Slovakia's relatively large share of direct exports to China, information that is widely known to most policymakers. As such, there is no tendency to trivialize the importance of China's demand for the country's economy.[47] Nevertheless, indirect trade exposure is absent from the debate and unknown to most policymakers. Despite its significance, in particular, its potential to act as a mechanism for transmitting the challenges in the Chinese economy into Slovakia, it is rarely mentioned and addressed.

Second, in recent years, Slovakia has received a large amount of Chinese investment. Previously, Slovak politicians' disillusionment with China was based primarily on a lack of Chinese investment. Just as in Czechia, CEFC was the only major Chinese investor in Slovakia.[48] However, with the rise of China's electric vehicles (EV) industry, Slovakia, with its large car manufacturing sector, is poised to receive a significant quantity of Chinese investment. For example, Volvo, owned by the Chinese firm Geely, invested €1.2 billion in 2022. That said, public discussions in Slovakia about this investment tend to overlook the Chinese aspect of the investment and focus on Volvo's Swedish origin. Gotion High Tech, another Chinese firm, purchased a 25% share in a Slovak battery producer InoBat.[49]

Chinese entry into Slovakia's automotive industry could be a blessing or a curse for Slovak-Chinese relations. If more Chinese producers invest in Slovakia, it may improve China's image among the Slovak public and politicians, as well as elevate China's position as a significant source of FDI. However, more Chinese investment might result in closer regulatory scrutiny and further increase notions about Slovakia's dependence on China.

Moreover, if Chinese car producers take a significant proportion of market share from their European and East Asian competitors, many of whom have factories and suppliers in Slovakia, it would adversely impact the Slovak economy. Both direct and indirect exports would decrease steeply, although direct exports (mainly from Volkswagen Slovakia) are in a much more vulnerable position. Policymakers should undoubtedly be worried about a 25% exposure to the Chinese demand for cars by Slovakia's largest taxpayer.[50] However, a structural change to Slovakia's economy would arrive mostly via a decrease in indirect exports, which would translate into lower supply chain activities and, in turn, lower production output and decreased public revenues.

It is too early to say whether Slovakia will be a winner or loser of the global automotive transformation we are witnessing. However, recent developments suggest that Slovakia is less successful in attracting investment in EV manufacturing than Poland and Hungary. Yet, it remains to be seen how much of Slovakia's automobile manufacturing infrastructure can be repurposed for EV production. This would also impact the country's future discourse and economic engagement with China.

Conclusion

Globalization, manifested by the development of global supply chains, has for decades been a key driver of economic growth in the V4 region, as it has been in China, too. However, amid rising competition between China and Western nations, various forms of economic links are under increased scrutiny, both on economic and security grounds.

While it has been recognized that direct economic links to China, such as imports of critical material or Chinese investment into strategic sectors, can be abused by political coercion, the weaponization of indirect exports is a much newer phenomenon.

As this analysis shows, the V4 countries are among the most economically exposed countries in Europe to China because of their often-ignored indirect trade links. Due to this, several key ramifications arise for the V4 countries:

1. Due to the nature of their manufacturing sectors and their position in global supply chains, export-related exposure to the Chinese market remains hidden from general discussions. Because China accounts for a relatively low share of direct exports of the V4 states, they tend to operate on the assumption of low trade exposure to China. However, due to their embeddedness in the German value chain, indirect exports (via third countries) account for the majority of their overall exports to China. The difference between China's share of their direct exports and its share of their indirect exports can be as much as 80-250%. Disregarding this significant portion of trade results in a significant underestimation of potential exposure risks and in the need for trade diversification and economic de-risking.

2. The relatively high exposure to the Chinese market, especially in the automotive industry, exposes the V4 countries to both the positive and negative impacts of changing consumer demand patterns within China. As Chinese demand for foreign-produced vehicles decreases, coupled with a rise in its domestic supply (especially from Chinese EV manufacturers), automotive companies in the V4 and their suppliers are at risk of significantly falling revenues. This will impact not only the financial performance of the companies

themselves but also employment and tax revenues, thus further exacerbating potential negative impacts.

3. Reducing their exposure to China requires implementing a tailored diversification strategy. However, since China is not the primary export destination for a large share of their products, the V4 states are limited in how they can promote diversification.

4. China's global dominance in EV and battery production presents another layer to the V4's China exposure risks. As they attempt to transition their automotive sectors from internal combustion engine (ICE) vehicle production to EV production, they face a two-fold threat: competing with Chinese EV producers at the same time as having to secure necessary supplies (especially of batteries) from Chinese suppliers.

5. Unfair competition in the EV sector due to the subsidization of Chinese producers has recently been identified as a major problem, leading to the opening of anti-subsidy investigations by the EU. While this approach might be objectively warranted, past experience (such as over China's production of solar panels) indicates that it might not be enough to ensure that European, including V4, automakers remain competitive.

6. Given the recent influx of Chinese investment in V4 battery production, countries in the region are running the risk of further increasing their exposure to China while shifting the risk from the demand to the supply side.

How to manage exposure risks?

Findings in this research can be incorporated into policymakers' toolkits in a number of ways. There is an increasing list of policy instruments that can be used in navigating and managing trade and investment relations with other countries. The policy recommendations listed below are country-agnostic and can be used to steer economic relationships between any two countries.

1. **Employ exposure approach in the audit of economic relations with China**
2. **Use net-benefit analysis in scenario analysis**
3. **Consider sectoral and geographic specifics**
4. **Strengthen public-private dialogue on supply chain risks**
5. **Weaponized transparency**
6. **Incorporate the disclosure of authoritarian exposures in ESG reporting**
7. **Promote whistleblower protection on disclosures of coercive action**
8. **Formulate contingency plans for high exposure entities**
9. **Apply long term view in risk management**
10. **Avoid authoritarian-for-authoritarian swaps**

Detailed description of outlined policy measures is provided in the first paper of the series – **The China factor: Economic exposures and security implications in an interdependent world**.

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