COUNCIL on FOREIGN RELATIONS

An Analysis of China's Economic Coercion Against Lithuania

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Lithuania is the southernmost and largest of the three Baltic states. As small states in a tough neighborhood, the Baltics have a particular stake in preservation of international rules, human rights, democracy, liberal economics, and peace. These Baltic traits have often brought the three states into tension with Beijing. None of the Baltic states, however, have come into conflict with China as much as Lithuania. In 2021, Lithuania became the first state to officially withdraw from the Beijing-led Cooperation between China and Central and Eastern European Countries initiative (China-CEEC, also known as 16/17+1). Lithuania also made a decision to allow the opening of a Taiwanese representative office in the capital of Vilnius, with the important point that the office was called a "Taiwanese" institution as opposed to a "Taipei" institution. Such a choice for a name contradicted a decades-long established practice across the globe, particularly considering that its Chinese language version included the two characters for "Taiwan," and thus came to be perceived as a dangerous and provocative step by Beijing.

As a result of these developments, Sino-Lithuanian relations have plunged to low depths. At the time of this writing, the official bilateral relationship has been de facto and unilaterally downgraded to the level of chargé d'affaires, Lithuania's physical embassy in Beijing is empty, and the small country continues to face an intense amount of not only diplomatic but also economic pressure from China. This paper focuses on how China has responded, with attempted economic coercion, to Lithuania's recent actions. It analyzes the measures Beijing has used, how they have affected Lithuania and its place in Europe, and the long-term lessons from Beijing's behavior toward Lithuania.

The State of Economic Relations Before the Crisis

Lithuania was not a particularly notable trading partner with the world's second largest economy. There arguably are only three factors that made it even somewhat attractive to Beijing. First, China recognized Lithuania's promising geographical position in the middle of the European continent, directly bordering China's two important strategic partners: Belarus and Russia, via the Kaliningrad exclave. Second, Lithuania's membership in the European Union (EU) may have further increased China's interest, with Beijing thinking it could utilize Lithuania to help promote infrastructure building and connectivity towards and within Europe, and to widen its access to one of the world's most developed markets. Third, China perceived Lithuania as a modestly significant source for some products and services needed to ensure China's rapid socio-economic and technological development.[1] However, none of these factors proved to be important enough for Beijing to reconsider its pressure campaign against Lithuania.

The Sino-Lithuanian economic relationship was modest and uneven even before the crisis. According to statistics from Lithuania, the country's bilateral trade volume with China expanded by 23.4 percent in 2020 after a 16 percent annualized growth the previous year. However, the total amount of bilateral trade amounted to roughly $1.6 billion, which was modest considering the size of the Chinese economy and consistent Lithuanian hopes for a much bigger trade volume and wider access to one of the world's largest markets. Actually, Lithuania ran a massive trade imbalance with China year after year, and its trade deficit with China almost reached $1 billion in 2020.[2]

Overall, only about one percent of total Lithuanian exports had gone to China in the years before the breakdown in relations.[3] Except for industrial lasers, most of Lithuania's exports to China consisted of

[1] Konstantinas Andrijauskas, "The dragon and the knight: China's growing presence in Lithuania," Vilnius: Eastern Europe Studies Center, February 16, 2020, pp. 5-6, https://www.eesc.lt/uploads/news/id1137/v07_Dragon-and-Knight_leidinys_A4.pdf.
[2] Lietuvos Respublikos užsienio reikalų ministerija, „Dvišaliai ekonominiai ryšiai su užsienio šalimis: Kinija," June 7, 2021, https://urm.lt/default/lt/lietuva-kinija.
[3] Aya Adachi et al., "Dealing with China's economic coercion – The case of Lithuania and insights from East Asia and Australia," Merics Executive Memo, December 20, 2021, https://merics.org/en/executive-memo/dealing-chinas-economic-coercion-case-lithuania-and-insights-east-asia-and-australia.

low value-added items, such as timber and agricultural products. On the other hand, the majority of imports from China comprised of higher value-added electronic and mechanical equipment.[4]

In the realm of services, there were, before the crisis, three potential areas of interest. The first of these – tourism – had naturally collapsed even before the bilateral crisis due to the COVID-19 pandemic, as only 1,145 Chinese tourists visited Lithuania in 2020, a drop of almost ninety-five percent year-on-year.[5] The second area, that of cooperation in logistics and e-commerce, had been more resilient, as Lithuania seemed to have convinced China of being a promising gateway for its postal goods to the entire European continent. Indeed, immediately before the pandemic, postal items sent from China had reached a remarkable share of two thirds of all incoming parcels processed by the state-owned Lithuanian Post,[6] and the need for a viable alternative to quarantine-related slowdown of air traffic resulted in the first ever Europe-bound wholly postal Chinese train to arrive in Vilnius from central China in mid-April 2020.[7] Last, Lithuania had some initial success in presenting itself as a European gateway for financial technologies as well, with at least nine Chinese fintech companies licensed to operate there before the pandemic.[8] However, none of these areas survived the diplomatic crisis unscathed.

China also was, even before the crisis, a modest source of foreign direct investment into Lithuania. It was the fortieth largest direct investor in Lithuania in 2020. For perspective, Lithuania's own investment into China was five times larger that year than China's investment into Lithuania.[9]

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[4] Lietuvos Respublikos užsienio reikalų ministerija.
[5] Ibid.
[6] Lietuvos paštas, "Lietuvos pašto rekordas: jei taip kasdien, per metus kiekvienas gautume 83 siuntas," January 9, 2020, https://www.xn--lietuvospatas-kuc.lt/lt/apie-mus/naujienos/lietuvos-pasto-rekordas-jei-taip-kasdien-metus-kiekvienas-gautume-83-siuntas.
[7] LRT.lt, "'First ever' Europe-bound postal train from China arrives in Lithuania," *LRT English*, April 14, 2020, https://www.lrt.lt/en/news-in-english/19/1163194/first-ever-europe-bound-postal-train-from-china-arrives-in-lithuania.
[8] Ministry of Finance of the Republic of Lithuania, "A network of fintech coordinators under the "17+1 Cooperation Format" between Central and Eastern European countries and China is created in Lithuania," November 27, 2019, https://finmin.lrv.lt/en/news/a-network-of-fintech-coordinators-under-the-17-1-cooperation-format-between-central-and-eastern-european-countries-and-china-is-created-in-lithuania.
[9] Lietuvos Respublikos užsienio reikalų ministerija.

To summarize, the general state of Sino-Lithuanian economic relations was already weak before 2021, due to the pandemic and also to policy choices made by the government in Vilnius. For instance, the outgoing center-left cabinet issued a landmark September 2020 joint declaration with the United States to strengthen cooperation on 5G security and development, in effect restricting the use of Chinese mobile technology, [10] one of the relatively few remaining promising areas in the Sino-Lithuanian bilateral economic relationship.

A Shift in Vilnius

As a result of general elections in October 2020, a new center-right government was formed in Vilnius. Its cabinet famously pledged that the Lithuanian government would implement what it called a "values-based foreign policy,"[11] with a review of Lithuania's bilateral relationship with China being one of the key aims of its international conduct from then on.

In a quick succession of decisions taken by the end of spring 2021, Lithuania attempted to ban China's increasingly controversial state-controlled Nuctech company from supplying X-ray scanning machinery to the country's airports over national security concerns,[12] recognized that Klaipėda's deep-water seaport project, long of interest to Beijing, would be postponed "for at least a decade,"[13] and passed amendments to the Law on Communications and the Law on the Protection of Objects of Importance to Ensuring National Security in effect prohibiting 'unreliable' manufacturers and suppliers from operating in Lithuania's digital communications market. [14] In other words, the state of Sino-

[10] U.S. Department of State, "United States – Republic of Lithuania Memorandum of Understanding on 5G Security," September 17, 2020,
https://2017-2021.state.gov/united-states-republic-of-lithuania-memorandum-of-understanding-on-5g-security/index.html.
[11] Andrius Sytas, "Lithuania to support those "fighting for freedom" in Taiwan," *Reuters*, November 9, 2020, https://www.reuters.com/article/us-lithuania-china-idUSKBN27P1PQ.
[12] Reuters, "Lithuania blocks Chinese scanning equipment on national security grounds," *Reuters*, February 17, 2021,
https://www.reuters.com/article/us-lithuania-china-idUSKBN2AH2AR.
[13] BNS, "Lithuania puts off deepwater port project eyed by China 'for at least a decade'," *LRT English*, April 2, 2021,
https://www.lrt.lt/en/news-in-english/19/1380360/lithuania-puts-off-deepwater-port-project-eyed-by-china-for-at-least-a-decade.
[14] BNS, "Lithuania bans 'unreliable' technologies from its 5G network," *LRT English*, May 25, 2021, https://www.lrt.lt/en/news-in-english/19/1417429/lithuania-bans-unreliable-technologies-from-its-5g-network.

Lithuanian economic relations was already deteriorating before the Taiwan-related diplomatic crisis started to develop in mid-2021.[15] And as will be shown below, even before the announcement about the Taiwanese representative office in Vilnius, China had begun to implement measures of economic coercion against Lithuania.

China Responds

In mid-2021, the Lithuanian government confirmed Taiwan's plan to open a representative office in Vilnius. This would be the first newly-opened Taiwanese institution in a European capital for almost two decades and the first among countries that do not have diplomatic relations with Taiwan to actually carry the title of the island as opposed to that of its largest city, as has been the practice worldwide. Except for the naming issue itself, Lithuania's decision should not have come as a surprise considering that the new government had explicitly stated that it "will actively oppose any violation of human rights and democratic freedoms, and will defend those who are fighting for freedom around the world, from Belarus to Taiwan,"[16] as well as the fact that the previous center-left government had already started deepening ties with the island-state.[17]

On the surface Beijing's response to this alleged naming insult seemed to have been surprisingly delayed. It also appeared to be initiated primarily through rather creative diplomatic, as opposed to China's usual economic, retributive measures. Indeed, it took three weeks after the announcement of the new Taiwanese representative office for the Chinese Ministry of Foreign Affairs (MFA) to make public a decision to recall its ambassador to Lithuania, and to demand Vilnius reciprocate.[18] The reality, however, was more complex, as China's delay was actually designed to make the Lithuanian ambassador a de facto hostage in Beijing for three weeks. Indeed, the Chinese MFA's announcement came on the exact day of

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[15] Konstantinas Andrijauskas, "Lithuania's decoupling from China against the backdrop of strengthening transatlantic ties," Vilnius: Eastern Europe Studies Center, August, 2021, pp. 4, https://www.eesc.lt/wp-content/uploads/2020/07/RESC.-Lithuanias-decoupling-from-China_2021_EN.pdf.
[16] Andrius Sytas, "Lithuania to support those "fighting for freedom" in Taiwan", *Reuters*, November 9, 2020, https://www.reuters.com/article/us-lithuania-china-idUSKBN27P1PQ.
[17] BNS, "Foreign minister's support for Taiwan draws 'strong dissatisfaction' from China," *Delfi.en*, May 14, 2020, https://www.delfi.lt/en/politics/foreign-ministers-support-for-taiwan-draws-strong-dissatisfaction-from-china.d?id=84275733.
[18] LRT.lt, "China recalls its ambassador from Lithuania", *LRT English*, August 10, 2021, https://www.lrt.lt/en/news-in-english/19/1466061/china-recalls-ambassador-from-lithuania.

the ambassador's return to China after a working trip back home, and thus she had to pass the compulsory quarantine before even being allowed to leave for Lithuania.[19]

On the other hand, China had been stepping up economic coercion in the months before the announcement. Following the rather usual pattern, Beijing initiated its pressure by applying some market access restrictions for exporters from Lithuania, apparently as a result of the country's withdrawal from the 17+1 initiative. Notably, China had used this type of economic coercion before against Lithuania, such as by freezing negotiations over Lithuanian food exports as a result of the private meeting between the country's then-president Dalia Grybauskaitė and the 14th Dalai Lama in 2013,[20] and a more recent crackdown on Lithuanian wheat deliveries following the previous government's support for Taiwan's participation at the 2020 World Health Assembly.[21]

According to the head of Lithuania's largest business association, credit insurance for trading with China became unavailable as early as spring 2021.[22] By the end of summer 2021, reports emerged about a freeze of new food export permits to the Chinese market.[23] Soon after, Lithuanian timber and grain exporters reported that Chinese firms refused to buy their products and Chinese stores took their goods off their shelves. The first key thing that made this stepped-up pressure unprecedented in a rather rich history of Beijing's economic statecraft against Vilnius was disruption of the supply of Chinese raw

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[19] The announcement curiously coincided with Diana Mickevičienė's landing in Beijing on August 10, which meant that she had to undergo a mandatory 21-day quarantine before leaving back home.

[20] *Re: Baltica*, *Verslo žinios*, *Postimees*, "The rough face of China's soft power in the Baltics – Investigation," *LRT English*, September 5, 2020, https://www.lrt.lt/en/news-in-english/19/1094318/the-rough-face-of-china-s-soft-power-in-the-baltics-investigation.

[21] Giedrius Surplys, "Lietuva-Kinija: kaip (ne)bendrausime su milžinu titano kojomis," *Delfi*, May 25, 2021, https://www.delfi.lt/news/ringas/politics/giedrius-surplys-lietuva-kinija-kaip-nebendrausime-su-milzinu-titano-kojomis.d?id=87275563.

[22] János Ammann, "Lithuanian businesses grind on under Chinese pressure," *EURACTIV*, January 18, 2022, https://www.euractiv.com/section/economy-jobs/news/lithuanian-businesses-grind-on-under-chinese-pressure/.

[23] BNS, *The Baltic Times*, "Beijing stops approving new permits for Lithuanian food exports to China – service," *The Baltic Times*, August 22, 2021, https://www.baltictimes.com/beijing_stops_approving_new_permits_for_lithuanian_food_exports_to_china___service/.

materials. In both cases of pressure through exports and imports China simply declined to make new contracts.[24]

Following the actual opening of the Taiwanese representative office in Vilnius on November 18, 2021, these two measures, namely pressure to Lithuanian exporters *and* importers, were stepped-up further, essentially destroying the bilateral trade relationship. Chinese customs data revealed a roughly ninety percent drop in shipments of goods from Lithuania in December 2021 as compared to both November 2021 and December the previous year.[25] According to representatives of Lithuanian industry, around sixty companies faced problems due to China's economic pressure in early 2022, as more than 1,200 containers of goods planned for Lithuania, worth an estimated $260 million, were not coming to the country, with related losses potentially accumulating to some $320 million by the end of the year.[26]

This type of bilateral economic coercion has been characterized by several important features. To begin with, Beijing denies imposing an official embargo on Lithuania, citing instead individual choices by Chinese enterprises and consumers or technical glitches in China's customs clearing system for the sudden drop in trade.[27] It was only after the EU filed a case against China at the World Trade Organization (WTO) in late January 2022 (see below) that Beijing officially suspended Lithuanian beef, milk and beer imports, notably without any provision of a credible reason for doing so.[28] Such a move

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[24] Erika Alonderytė, BNS, "Lithuanian businesses report supply disruptions amid Vilnius–Beijing tensions," *LRT English*, September 17, 2021, https://www.lrt.lt/en/news-in-english/19/1498383/lithuanian-businesses-report-supply-disruptions-amid-vilnius-beijing-tensions.

[25] Finbarr Bermingham, "Lithuanian exports nearly obliterated from China market amid Taiwan row," *South China Morning Post*, January 21, 2022, https://www.scmp.com/news/china/diplomacy/article/3164170/lithuanian-exports-nearly-obliterated-china-market-amid-taiwan.

[26] LETA, *The Baltic Times*, "Lithuanian industry may lose around 300 million euros due to China's pressure in 2022," *The Lithuanian Tribune*, January 4, 2022, https://www.baltictimes.com/lithuanian_industry_may_lose_around_300_million_euros_due_to_china_s_pressure_in_2022/.

[27] Finbarr Bermingham, "EU launches WTO case against China over Lithuania embargo, as row over Taiwan office continues," *South China Morning Post*, January 27, 2022, https://www.scmp.com/news/china/diplomacy/article/3164845/eu-launch-wto-case-against-china-over-lithuania-embargo-row.

[28] LRT.lt, BNS, "China suspends Lithuanian beef, milk, and beer imports in further escalation of Taiwan row," *LRT English*, February 10, 2022, https://www.lrt.lt/en/news-in-english/19/1612188/china-suspends-lithuanian-beef-milk-and-beer-imports-in-further.

clearly indicated Beijing's willingness to strengthen its very thin legal basis for actions taken against Vilnius.

Notably, no sector of the Lithuanian economy proved to be immune from these coercive measures – not even industrial lasers, one of Lithuania's top export items to China before the crisis, long perceived as relatively immune to negative impact of worsening bilateral relations. As the coercive measures bit hard by the end of 2021, not only the political opposition and some entrepreneurs but also Lithuanian former heads of state were criticizing the government over the naming issue. Most importantly, the country's current president Gitanas Nausėda, the head of state, publicly said that the office's naming had been a "mistake."[29] The results of a representative poll conducted in December revealed a clear lack of popular support for the government's policy.[30] Such a seemingly radical shift of perception was caused not only by damage directly inflicted on Lithuanian businesses dealing with China, but also by Beijing's use of indirect coercive measures that targeted Lithuania's position in global supply chains.

Indeed, soon after the opening of the Taiwanese representative office, several European multinational companies reported that China had blocked their imports merely because of Lithuanian components, while the German companies operating in Lithuania eventually went as far as themselves advocating the authorities in Vilnius to back down in their dispute with Beijing.[31] Lithuania's government started to hesitate, as this time open criticism poured in not only from Lithuanian companies but also the corporate sector associated with its close political allies and economic partners, and thus Lithuania's entire investment environment and economic development in general suddenly seemed to be at stake.

As we have noted with other Beijing efforts to teach Vilnius a lesson, China's first attempts to target multinational companies operating in Lithuania actually preceded the opening of the Taiwanese representative office. Indeed, Beijing apparently applied some pressure on an American biotech

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[29] BNS, "Allowing Taiwan to open office under its name was a mistake – Lithuanian president," *LRT English*, January 4, 2022, https://www.lrt.lt/en/news-in-english/19/1580082/allowing-taiwan-to-open-office-under-its-name-was-a-mistake-lithuanian-president.

[30] LRT.lt, BNS, "Most Lithuanians critical of Vilnius' China policy – survey," *LRT English*, January 12, 2022, https://www.lrt.lt/en/news-in-english/19/1586875/most-lithuanians-critical-of-vilnius-china-policy-survey.

[31] Andrius Sytas and John O'Donnell, "German big business piles pressure on Lithuania in China row," *Reuters*, January 21, 2022, https://www.reuters.com/world/europe/german-big-business-piles-pressure-lithuania-china-row-2022-01-21/.

heavyweight, Thermo Fisher Scientific, to de-invest from the Baltic country as early as August 2021.[32] Gladly for Lithuania, neither they nor other affected multinationals, such as the German automotive giant and another key foreign investor, Continental AG, have bent thus far. Notably, Lithuania's financial regulator estimated that China's economic coercion measures could cause a drop in Lithuanian GDP growth of as much as 0.5 percentage points in 2022 and as much as 1.3 percent in 2023, in the worst-case scenario of indirect negative effects on Lithuania's role in the global supply chain and investment environment, that is if Western multinationals would leave the country after all.[33]

Lithuania's key foreign policy makers later recognized that they did not anticipate what were essentially Chinese attempts at indirect sanctions against their country,[34] producing what an informed local scholar aptly referred to as an "unforeseen asymmetrical interdependence trap."[35] Indeed, one can hardly overestimate the significance of China's attempts at coercion by these disproportionate measures against Lithuania, since China is so critical to much of the world's supply chains.

But China's escalation of a bilateral dispute with Lithuania to the level of involving the EU's entire Single Market by pressuring other European states to isolate Lithuania has not worked so far for Beijing. Indeed, both the EU and the U.S. expressed emphatic support for Lithuania. Brussels in particular adopted a proposal for an Anti-Coercion Instrument and launched a case against China at the WTO[36] which was tellingly joined by an impressive group of countries also at odds with it, namely the U.S., UK, Canada, Australia, Japan, and Taiwan. In the meantime, Washington, Brussels, and Taipei have offered

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[32] Edward Lucas, "Showdown in Vilnius," Center for European Policy Analysis, August 21, 2021, https://cepa.org/showdown-in-vilnius/.

[33] Jonas Deveikis, "China sanctions vs Taiwan investments – Lithuania's central bank weighs economic impact," *LRT English*, January 21, 2022, https://www.lrt.lt/en/news-in-english/19/1593215/china-sanctions-vs-taiwan-investments-lithuania-s-central-bank-weighs-economic-impact.

[34] Sofija Lapėnienė, LRT.lt, "Lithuania's FM failed to anticipate China's full retaliation over Taiwan," *LRT English*, January 11, 2022, https://www.lrt.lt/en/news-in-english/19/1585384/lithuania-s-fm-failed-to-anticipate-china-s-full-retaliation-over-taiwan.

[35] Vida Mačikėnaitė-Ambutavičienė, "Lithuania's Unforeseen Asymmetrical Interdependence Trap with China," The Prospect Foundation, February 25, 2022, https://www.pf.org.tw/article-pfen-2076-7896.

[36] European Commission, "EU refers China to WTO following its trade restrictions on Lithuania," January 27, 2022, https://trade.ec.europa.eu/doclib/press/index.cfm?id=2355.

Vilnius additional economic support, including a $600 million export credit agreement with the U.S. Export–Import Bank,[37] a EU rough $140 million aid initiative to support Lithuanian firms affected by China's actions,[38] a Taiwanese $200 million investment fund for Lithuanian industries, and a Taiwanese $1 billion fund for bilateral joint ventures.[39] At the time of this writing, the government in Vilnius seems to have returned to its previous defiant mode against Chinese economic coercion, although the issue has been naturally overshadowed by the war in Ukraine.

Conclusions

China's ongoing multi-dimensional pressure campaign against Lithuania is arguably one of those rare cases that could be instructive of wider shifts in global diplomatic and economic international order. Beijing's decision to apply indirect secondary sanctions that target global supply chains and therefore the international trade system is relatively unprecedented at least for this emerging Asian superpower.

China's economic coercion, applied against Lithuania, predictably started from market access restrictions to its exporters, a tactic already used previously in their interactions. However, the subsequent disruption of Chinese imports, particularly raw materials, to Lithuania was something novel in the history of this relationship. However, even these two bilateral means put together paled in comparison to China's stratagem of exploiting multinational companies, something that attracted considerable attention and concern worldwide. And in all of its efforts at economic coercion, Beijing never officially announced it was even taking such disproportionate measures. Ultimately, if China succeeds in getting Lithuania to cave to its coercion, or to get other European countries to pressure Lithuania to cave, it will set an example Beijing could replicate in many other parts of the world.

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[37] "China downgrades its diplomatic ties with Lithuania over Taiwan issue," *CNN*, November 21, 2021, https://edition.cnn.com/2021/11/21/china/china-lithuania-taiwan-relations-intl-hnk/index.html.

[38] Finbarr Bermingham, "EU approves funding for Lithuanian companies hit by Chinese trade embargo," *South China Morning Post*, April 27, 2022, https://www.scmp.com/news/china/diplomacy/article/3175617/eu-approves-funding-lithuanian-companies-hit-chinese-trade.

[39] LRT, "Taiwan to launch $1bn loan fund for joint projects with Lithuania – minister," *LRT English*, January 11, 2022, https://www.lrt.lt/en/news-in-english/19/1585633/taiwan-to-launch-1bn-loan-fund-for-joint-projects-with-lithuania-minister.