



📷 *Jacob Mardell*

ASIA POLICY BRIEF

## China's Economic Footprint in the Western Balkans

Geopolitics has returned to vogue, and the EU does not enjoy a monopoly on influence in the Western Balkans. China is the latest player on the scene, and although its economic footprint is still relatively small, Beijing's growing presence is a new reality that Brussels needs to contend with. China's "no-strings attached" financing of infrastructure potentially undermines the EU's reform-orientated approach.

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### Relevance

**Relevance**  
Why we care

The EU has deemed China a "systemic rival." Beijing's growing influence in the Western Balkans – a strategically vital, non-EU enclave in the heart of Europe – is thus cause for concern in Brussels.

## Focus



China's economic footprint in the Western Balkans largely consists of transport and energy projects funded by concessional Chinese credit and contracted to Chinese state-owned enterprises. Although many projects have been announced, few have been turned into reality.

## Forecast



## Information

## Information

### Where we know too little

More research needs to be conducted on the soft power and political elements of China's outreach. Beijing is mainly involved in economic cooperation, but "people to people" projects may have significant long-term effects. Local China expertise is also scarce, providing opportunities for Beijing to fund friendly voices.



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## Options

### Options

#### What should be done

Brussels' focus should be on fixing its own relationship with the Western Balkans before criticizing Beijing. It should also help build local institutional capacity and enhance local China expertise in order to counter the more pernicious effects brought about by the Chinese model of infrastructure development.



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## About the author

**Jacob Mardell** is a freelance researcher and journalist who has recently travelled Eurasia exploring China's Belt and Road Initiative. He is writing a series of articles, "On the New Silk Road". Since March, he has traveled overland from the UK to Beijing. Over the next five months he will be

travelling in Southeast Asia, returning to Europe over sea, via Djibouti and Ethiopia.

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## **Beijing's approach**

China's economic presence in the Western Balkans Six (WB6) countries of Albania, Bosnia & Herzegovina, Kosovo, Montenegro, North Macedonia, and Serbia is framed in terms of the Belt and Road Initiative (BRI), a foreign policy slogan and development concept announced by Xi Jinping in 2013. Although China maintained active diplomatic relations with Yugoslavia during the 1980s and 1990s and vocally opposed the NATO bombing of Serbia and Montenegro in the late 1990s, economic outreach in the countries of former Yugoslavia only truly began (with Serbia) in the second decade of the 21st Century. Beijing's relationship with Albania – not part of former Yugoslavia – was very close until the Sino-Albanian split of the 1970s, but this historical curiosity has little bearing on contemporary Sino-Albanian relations.

While an awareness of the BRI is essential to understanding China's foreign policy in general, it is not necessarily a useful guide to predicting developments on the ground. The BRI is less a concrete route from A to B, and more a foreign policy concept that describes several abstract policy goals, including but not limited to: growing overseas markets, occupying and developing the capacity of Chinese companies, and deepening Beijing's economic leverage abroad. BRI projects are not masterminded in Beijing. They are usually items on local government wish lists that appeal to Chinese companies and financial institutions.

Apart from Kosovo, whose independence Beijing does not recognize, all the WB6 have memoranda of understanding (MoU) with China on the BRI. Decision makers are broadly enthusiastic about the initiative, seeing it either as a harmless marketing label that generates political kudos with Beijing, or as a genuine opportunity to position their countries as logistics hubs along the Belt and Road.

A year before the BRI's launch, Beijing also established the China-Central Eastern European Cooperation Forum, otherwise known (since the addition of Greece last year) as the 17+1 format. The 17+1 framework is billed as Chinese-led multilateralism, but concrete deals and the implementation of development projects are often realized between China and individual countries on a bilateral level. The 17+1 framework has obvious antecedents in China's experiences with "South-South" cooperation in Africa and Latin

America, as does the financing model that China prefers for infrastructure development in 17+1 countries. The fundamental formula for this model is state-guaranteed finance linked to contract guarantees for Chinese companies. Because rules on public tenders prohibit such an approach within the EU, none of the \$10 billion credit line offered to 16+1 countries in 2012 has been utilized within the EU.

Instead, Chinese credit has been flowing to the five non-EU members of the 17+1 (WB6, excluding Kosovo). Even more so than elsewhere along the BRI, large, state-guaranteed loans for transport and energy projects characterize China's economic footprint in the Western Balkans.

This brief does not look in detail at trade, but most of the WB6 have witnessed a large growth in trade with China over the past decade. As is the case with many of China's trading partners, this growth masks a very unbalanced trade relationship. Exports to China from Albania, Montenegro, Serbia, and Bosnia & Herzegovina have grown as a percentage of total exports since 2013 but remain at a very low level. Like most trading nations, the WB6 look enthusiastically to Chinese markets for growth, but although Serbia, particularly in the meat industry, has had some success, reality probably falls short of ambitions.

## **Serbia**

Out of all the WB6, Serbia is by far the largest recipient of Chinese finance. The Serbian public, and even more so the Serbian government, look favorably on China, which forms one of the "four pillars" of Serbian foreign policy. China and Serbia upgraded their relationship to a "Comprehensive Strategic Partnership" in 2016, the same year they signed a mutual visa-exemption agreement. Due to its own territorial concerns, Beijing considers Kosovo, which declared independence in 2008, a part of Serbia, and in Belgrade this position is frequently cited as a cornerstone of Sino-Serbian friendship. Poignantly underlining the occasional anti-Western sentiments the two countries share is a Chinese cultural center that is being built on the site of the NATO-bombed Chinese embassy in Belgrade.

The Export-Import Bank of China (henceforth Exim) has provided at least \$3.18 billion in funding for transport and energy projects in Serbia, although it is unclear how much of this money is outstanding as the Bank of Serbia does not provide a country-by-country breakdown of external debt. In the road sector, Exim is funding parts of Corridor XI, or the E-763, a route that will run from Belgrade to the Montenegrin border. It is also financing a related highway from Surcin to Obrenovac, as well as several lots of the Belgrade Bypass Project.

China's first big project in the region, the Pupin Bridge, was also funded by Exim. Chinese Premier Li Keqiang attended the opening ceremony in 2014, and flags above the road still herald the project as a testament to successful Sino-Serbian cooperation.

In the rail sector, Exim is funding the Serbian side of the Budapest-Belgrade railway. While retrospective enforcement of EU procurement rules meant that the project was re-tendered on the Hungarian side, there have been no such issues in Serbia. Two of the three sections are with Chinese companies, while the remaining middle portion of the route is being built by Russian Railways.

Chinese companies are also constructing and providing equipment to coal-fired power plants in Serbia. Only one of these Chinese-built plants – Kostolac B3 – is connected to a state-guaranteed loan from China. The cost of the plant, and details of the contractual arrangement, are reported to be far from optimal by industry insiders.

All of the above Exim loans have been extended to finance 85% of project costs. Interest rates vary from project to project but are largely concessional, at around 2% to 3%. Repayment periods are from 15 to 30 years, usually with a grace period, depending upon the size of the loan. Participation of local companies and labor tends to be around 50% in most projects.

There are several other infrastructure projects for which MoUs have been signed with China. Some of these may yet see the light of day, but many more BRI projects are announced than ever come to fruition. Two projects worth keeping an eye on are plans to build a new Belgrade metro system in 2020, as well as a new industrial park in Borca. Given the authoritarian inclinations of Alexander Vucic, Serbia's president, it is also worth mentioning Huawei's safe city project in Belgrade, through which it is supposed to have installed 1,000 high-definition surveillance cameras.

Almost uniquely in the WB6, Serbia is also host to several large Chinese equity investments, the poster child of which is the 2016 purchase by Hesteel of the ailing Smederevo steel mill for €46 million. It is doubtful that the acquisition had compelling economic motivations, but it was a prescient political move. Hesteel pledged to keep on the 5,050 workers it inherited, and to invest \$300 million in the future of the plant. Xi Jinping himself inaugurated the plant, and the operation reportedly started turning a profit within six months. Shandong Linglong are responsible for the first major greenfield investment in the region – a tire factory in Zrenjanin planned to cost around \$900 million.

## **Bosnia & Herzegovina (BiH)**

Cooperation between China and Bosnia & Herzegovina remains limited, encompassing the usual range of Confucius Institutes, low-level cultural exchanges, Sino-Bosnian friendship associations, and the presence of ubiquitous Chinese companies like Huawei. Although, following on from Serbia, BiH also has a visa-free regime in place with China.

Limited cooperation is in part due to the incredibly complex political structure stipulated by BiH's constitution, an annex to the Dayton Peace Agreement that ended the Bosnian War. Chinese companies are slightly more active in the Republika Srpska (RS), the autonomous Serb-majority region that forms part of BiH.

As in Serbia, Chinese companies in BiH are mostly involved in constructing power plants and highways. Throughout BiH, preliminary contracts have been signed on multiple thermal plants, but few have gone anywhere. For instance, Ugljevik III was reportedly financed with a \$782 million loan from China Development Bank (CDB), but the project now appears to have been shelved.

Tuzla B or Tuzla Block 7 is the only Chinese project in BiH connected to a state-guaranteed loan. The project has faced fierce opposition from environmental groups and the EU Energy Community Secretariat, which says BiH's state guarantee contravenes EU law regarding state aid to the energy sector. Locals argue that Tuzla B will replace less efficient plants and that countries like Germany went through the same modernization process years ago.

In the highway sector, China Shandong International last year secured a concession contract to build the highway between Banja Luka and Prijedor. The project is currently under fire because the RS government is reported to have guaranteed a minimum toll fee without performing adequate traffic analysis on the route.

## **Montenegro**

According to the World Bank, Montenegro has a population of 622,345 and a 2018 GDP of \$5.452 billion, making it the smallest country in a region of small countries. Montenegro is host to only one Chinese infrastructure project, yet it is the most ambitious and expensive project in the Western Balkans.

The 41km section of highway running from Smokovac to Matesevo and currently under construction by China Road and Bridge Corporation (CRBC) is envisaged to form part of a larger, 170km route that will extend from the Adriatic port of Bar to Boljare on the Serbian border.

Exim is providing 85% of the funding for the government's €810 million contract with CRBC. This figure does not take into account currency fluctuations or additional works (like electricity supply), meaning the project cost will likely end up exceeding the \$810 million figure. The loan agreement with Exim specifies a loan facility up to the amount of \$944 million, but the Ministry of Finance reports that €571.13 million is the amount outstanding as of March 2019. The government estimates that the remainder of the Bar-Boljare highway will cost an additional €1.7 billion.

Debate over the highway is incredibly polarized (and largely partisan) in Montenegro. Critics claim that the project lacks transparency, causes environmental harm to the UNESCO protected river Tara, and facilitates corruption, but the main line of criticism simply questions the economic rationale of such an expensive project. Both the IMF and World Bank have suggested in reports that they consider the highway a fiscally irresponsible move. The government argues that the new highway will save lives lost on the dangerous existing road, as well as better integrate the impoverished North of the country.

## **North Macedonia**

China's economic footprint in North Macedonia is also limited to the highway sector. The Kicevo-Ohrid and Miladinovci-Stip highways were both awarded to the Chinese company Sinohydro and are being financed by a concessional Exim loan.

Both highways have been plagued by difficulties and delays, requiring several annexes to the original contracts. Construction on both sections was begun in 2014, with the original completion date for the Kicevo-Ohrid section scheduled for 2018. In 2015, the highways were implicated in the series of salacious audio recordings steadily released by then opposition leader Zoran Zaev. In one of these tapes, the transport minister and prime minister can be heard discussing how much they might be able to extort from Sinohydro in bribe money. When Zaev's government came to power, several ambiguous technical difficulties came to light, causing the government to halt both projects. The Miladinovci-Stip section opened in June 2019, and the Kicevo-Ohrid section is supposedly under construction, but as of June 2019, much of the road appeared abandoned.

## **Albania**

Despite Tirana enjoying a special relationship (until the Sino-Albanian split of the early 1970s) with Beijing under the isolationist Communist regime of Enver Hoxha, Chinese presence in Albania is minimal.



In 2016, China Everbright was given a concession to operate Tirana International Airport. China's Geo-Jade Petroleum also holds the rights to exploit Europe's largest onshore oilfield, located in South Central Albania, although this came about through the acquisition of a Canadian firm, Bankers petroleum, in September 2017.

A Chinese company was due to construct the Arber highway in Albania using a loan facility from Exim, but this deal appears to have fallen through. Some interlocutors suggest that negotiations failed due to terms of financing, while others claim that lobbying pressure from the United States, a staunch and traditional ally of Albania, may have had something to do with the decision.

## **Kosovo**

Kosovo is one of the few countries on earth with almost no Chinese economic footprint to speak of. This is due to the fact that when Kosovo declared independence in 2008, Beijing condemned the move, even entering written evidence against Kosovo at the International Court of Justice a year later.

## **Motivations and characteristics**

China's economic footprint in the Western Balkans is characterized by the state mercantilist coupling of Chinese engineering muscle in road, rail, and energy sectors, with concessional Chinese credit, specifically Exim loans at 2% to 4% interest financing. A Chinese state-owned enterprise (SOE) is always the general contractor, using Chinese equipment and labor. There is usually a requirement for the use of local subcontractors and workers, which typically ranges from 30% to 60%. Chinese equity investments in the Western Balkans are few and far between, with Serbia serving as something of an outlier, being the WB6 country with by far the most sophisticated level of economic cooperation with China. In general, it is worth recognizing that when we talk of "China's economic footprint in the Western Balkans," we are largely talking about China's activity in Serbia.

Chinese projects in the Western Balkans often have long histories predating Chinese involvement. There is no BRI project pipeline. Projects are instead chosen from local government wish lists. Sometimes they are projects that the government tried and failed to get off the ground previously, as is the case with the Bar-Boljare highway, which has had consistent trouble finding financiers. Beijing is good at funding projects that others have turned up their noses at. Coal plants, for instance, face limited funding opportunities because many international financial institutions (IFIs) have stringent criteria for financing coal, or do not fund it at all. For many projects in the Western Balkans, Beijing is a lender of last resort.

The Western Balkans is also something of a “plan B” for China. Beijing does not deliberately make unsustainable loans for the purpose of ensnaring countries in debt traps, but Exim does have a greater appetite for commercially dubious projects than IFIs like the European Bank for Reconstruction and Development (EBRD). This is partly because the money always goes to pay a Chinese SOE anyway. China essentially wins several times on these deals, employing SOE capacity, earning interest, and, if everything goes well, generating goodwill with host countries.

The practice is also a valuable learning experience for Chinese companies. China is unable to deploy its loan-contract model in the EU, where public procurement laws prohibit such practices. Yet four of the WB6 are EU candidate countries, and two have moved on to formal membership negotiations. Through working in Montenegro, for example, CRBC can familiarize itself with European environmental standards. In this sense, the Western Balkans is a practice ground for graduating to the more lucrative EU market. CRBC is currently building an EU funded bridge in Croatia, and it is unlikely that it would have won the tender were it not for its prior experience in Europe. Of course, when and if any of the WB6 actually join the EU, China’s investments will become all the more worthwhile.

### **Competition or synergy – Is China a threat to EU interests?**

The outgoing EU Commissioner for Enlargement, Johannes Hahn, has warned against leaving a “vacuum” in the Western Balkans that “other powers would only be too happy to exploit.” Hahn has also singled out China for scrutiny, going so far as to suggest that Chinese and Russian influence in the region should be of equal concern to the EU.

Before addressing these concerns, it is worth putting China’s presence into context. Even in Serbia, the EU still eclipses China in economic importance. The Bank of Serbia’s debt (March 2019) to all foreign governments’ development banks and agencies stands at €2,122.4 million, compared to €2,449 million owed to the European Investment Bank (EIB). In terms of FDI, Germany, Netherlands, and Russia are all more important investors than China, as of Q4 2018. On trade, China accounted for 0.37% of Serbian exports in 2017, while Italy and Germany alone accounted for 25.76%. China does not offer a competitive alternative to European integration, and no policy maker in the WB6 is under any illusion that it does.

Beijing’s activities in the Western Balkans complement EU interests to some extent. The region suffers from a chronic infrastructure gap that seriously hampers economic “catch up,” and thus European integration. By pumping cash

into the region, Beijing is helping plug this gap. The EU should take at face value Beijing's claims that it stands behind European integration. Of course, it does not do so from any sense of appreciation for EU values, but because of its own strategic interests. Unlike Russia, China has a fundamental interest, and now a stake, in the region's prosperity and stability. Beijing would be very happy to see Serbia join the EU, and it is more ambivalent than Russia on the issue of NATO accession.

On the "competition" side of the ledger, China's presence means, firstly, more competition for European companies. While China's footprint sometimes receives more media attention than its size warrants, Beijing's presence in the Balkans has grown dramatically in a short period of time. It is possible that a lot of concern about China in the Western Balkans stems from the lobbying efforts of Austrian and German construction companies that are worried about losing ground to newcomers from China. This concern is part of a wider conversation the EU needs to have about subsidies, industrial strategy, and the extent to which it can adhere to its free market principles in the face of Chinese state mercantilism.

Secondly, Beijing's methods have problematic consequences. Beijing funds coal and commercially dubious projects that the EU would rather see left unbuilt. Exim also has far fewer scruples than EU-led institutions like the EBRD, with its stringent social, environmental, and other regulatory standards. Chinese money is therefore more likely than European money to fuel corruption, misconduct, and projects that deviate from desired EU standards.

Chinese banks and companies don't import corruption from China – it is endemic and indigenous to the Western Balkans, where kickback rates are anecdotally much higher than in China. The problems outlined above are fundamentally local. For example, it is up to Montenegro to ensure that CRBC adheres to environmental standards. Like an unscrupulous bank handing out subprime mortgages, Beijing simply enables reckless behavior where the borrower is inclined to be reckless. Where institutional capacity and competence is relatively high, as in Serbia, Chinese money is less of a problem.

Thirdly, and more abstractly, Beijing's footprint is a normative challenge to EU influence. In its own words, the European Commission considers China a "systemic rival promoting alternate forms of governance." China is not actively promoting authoritarianism in the Western Balkans, but it does provide an alternate model of non-conditional development that many in the region find appealing.

China's development aid globally and the BRI in general is characterized by "inclusivity" and "attention to local conditions." These characteristics are contrasted with the "traditional" developmental approach of Western financial institutions and governments. What inclusivity means in practice is that Beijing's "no-strings attached" finance makes no distinctions between authoritarian and democratic governments, and that it does not condition aid on reform and compliance with Western development practices. What "attention to local conditions" means in practice is that Beijing is happy to give local governments what they want, i.e. coal plants.

In the Western Balkans, China's approach is contrasted by locals with that of the EU, and enthusiasm for fostering relations with Beijing is often presented as the flipside of dissatisfaction with Brussels. In its relations with the WB6, Brussels is characterized by many as patronizing and demanding, and as caring little for the region. Beijing, on the other hand, is portrayed as deeply interested, attentive to local conditions, and is thought to treat regional governments as equals. One interlocutor suggested Brussels could learn from Beijing in behaving less like a "mentor" and more like a "partner."

Chinese banks do not directly compete with EU institutions to finance projects, but they do provide a source of finance free from the political conditions that EU money is often tied to; in theory, Beijing diminishes the leveraging power of this reform-orientated capital by providing a development path that is easier for local politicians to tread.

In sum, China's footprint in the Western Balkans does not mount a fundamental challenge to European integration or regional stability. It does, however, squeeze EU business interests and fuel practices that are at variance with efforts to combat corruption and promote EU standards in the region. China's "no-strings attached" model also challenges EU normative power.

There is no attractive alternative to European integration, but closer relations with Beijing present an attractive auxiliary option, especially as EU accession becomes an increasingly distant prospect.

### **What can we learn from Beijing?**

While Beijing doesn't offer an alternative to European integration, there is a sense in the Western Balkans that EU membership is either a long way off or unlikely altogether. As such, greater engagement with China is a tempting auxiliary option.

The recent veto by France of accession talks with Albania and North Macedonia is incredibly significant and has led to widespread feelings of

abandonment and anger. By changing North Macedonia's name to appease Greece, the ruling party committed a huge act of political sacrifice in return for the promise of accession talks. In an interview with the Financial Times, North Macedonian Prime Minister Zoran Zaev said the decision to delay talks "gives space for third forces, which are not very helpful, who do not offer us democracy, freedoms, and rule of law." In a separate interview, Serbia's Alexander Vucic said the move vindicated his policy of cultivating stronger ties with Russia and China.

In on-the-ground interviews and surveys conducted for this brief, frustration with Brussels and the EU integration process was almost universal. There is a perception that Brussels has demanded much while delivering too little for too long.

If Brussels is truly concerned about giving ground to Beijing in the Western Balkans, it should increase its commitment to the region and occupy the "vacuum" left by a perceived European retreat. Chinese power is a reality the EU needs to contend with. Forbidding Western Balkan partners to cultivate ties with Beijing will only entrench perceptions of Brussels as didactic and unresponsive. Portraying Beijing as an invasive actor discounts local agency and overlooks very real pro-China sentiment in the region. An attitude adjustment is called for – Brussels and EU member states need to recognize that, even in this European neighborhood, the EU isn't the only actor of relevance. Making real commitments on EU accession is a necessary first step in challenging the influence of "external actors" like China.

Within the region, the EU should continue engaging with China. The room for synergy between Chinese and EU interests is limited, but initiatives like the EU-China connectivity platform and efforts to form synergies between the EU's own infrastructure initiatives and the BRI cost little. Beijing has few incentives to make the BRI truly multilateral, because the loan-tied contract paradigm is one that works very well for China, but Beijing is also clearly interested in learning more about European standards and development practices. Brussels can't force Chinese companies to cooperate, but exposing Beijing to European expectations through a more active pursuit of joint projects is a start. European-led institutions like the EBRD should also continue to explore co-financing with Chinese banks. Opportunities may be few and far between, but working on a project with Exim would be an excellent learning experience for both sides.

To counter the corruption, bad practices, and debt risk facilitated by Chinese money, Brussels should build local institutional capacity and provide a supporting role. The EU cannot tell sovereign nations in desperate need of

ready infrastructure to ignore Beijing's convenient finance-engineering package, especially not without making attractive alternatives available. Instead, the EU needs to mitigate risks where it can.

There is also a massive knowledge deficit in China expertise throughout the WB6 including Serbia. There are few funds available for think-tank work on China, and there are not many people who have Chinese language skills or working knowledge of China. The individuals most active in private and public discussions on China tend to be officials, journalists, and academics just returned from trips to Shenzhen, who are overwhelmed by the supposed efficiency of the Chinese model. Chinese embassies are more than happy to step into this funding gap, and in Serbia at least, all but one of the "China experts" appear to parrot the rhetoric of Chinese Communist Party officials. An effective step Brussels could take to counter potentially pernicious effects of Chinese influence is to simply fund more research on China.

In an ideal world, Brussels could best balance Chinese influence by making firm commitments (and keeping them) on the EU accession process, and by increasing financial assistance to the whole of the WB6. Brussels should not attempt to move closer to Beijing by beginning to fund lignite coal in Bosnia, but it might consider making renewable alternatives more readily available. The appeal of Beijing to many Western Balkan countries is largely that, as a newcomer, China lacks the historical baggage that accompany relations with "the West." In considering Chinese influence in the Balkans, Brussels should recognize the agency of local governments and stop treating them as passive objects of Chinese influence. Ultimately, Brussels' best course of action is to focus on fixing its own relationship with its European neighbors.



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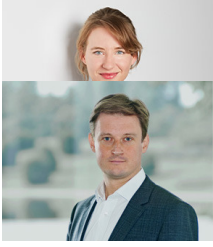
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