China’s Road: into the Western Balkans

by Plamen Tonchev

The Belt and Road Initiative (BRI), previously referred to as the One Belt, One Road (OBOR) initiative, is seen by many as an ambitious game-changing plan devised by China to project its increasing economic and political power worldwide – even if in geographical terms it covers ‘only’ Eurasia and eastern Africa.

Although, at present, Beijing’s precise rationale behind the BRI is less than clear, it can be assumed that this sinocentric initiative emulating the ancient Silk Road aims to address:

- The need to reduce transportation costs for Chinese commodities – a significant aspect of the country’s export-driven model;
- The overcapacity in certain sectors of China’s economy, such as its steel and cement industries - currently, Chinese construction companies, manufacturers and other businesses that have thrived on the country’s building boom increasingly have to look for opportunities abroad;
- China’s eagerness to invest its huge foreign exchange reserves (estimated to be in excess of $3 trillion in late 2016);
- Beijing’s promotion of the renminbi as a global reserve currency; indeed, in October 2016, the renminbi joined the International Monetary Fund’s basket of reserve currencies – a milestone in China’s campaign for recognition as a leading economic power;
- The need to boost the economies along BRI routes and thus increase demand for Chinese goods and services.

For the time being, four years after President Xi Jinping announced the initiative in 2013, the main thrust of the BRI has been in Asia. However, eastern European countries, including the Western Balkans, are also becoming increasingly involved in related discussions and projects on its western end.

A complex regional scene

While the region is ringed by EU member states (Bulgaria, Croatia, Greece, Hungary, Italy, Romania, and Slovenia), none of the so-called Western Balkans Six (WB6) – Albania, Kosovo, the former Yugoslav Republic of Macedonia, Serbia, Montenegro, and Bosnia and Herzegovina – are part of the Union.

WB6 members are involved in the so-called Berlin Process, a series of annual summits which started in 2014 and aim to reaffirm the region’s European perspective by improving regional cooperation, economic growth and political stability. Five WB6 countries, with the exception of Kosovo, are members of the Southeast European Cooperative Initiative (SECI), while only Albania is a member of NATO.

Adding to the complexity, Russia still wields significant influence in the Western Balkans, mainly because most countries in the region remain dependent upon Russian natural gas deliveries. Notably, Moscow has refused to recognise Kosovo as an independent state.

With regard to China's role, Beijing has always pursued a strategy of building political support among a large number of relatively small developing countries. The area of the Western Balkans is no exception, though the regional context clearly needs to be factored in. During the wars that followed the disintegration of Yugoslavia in the 1990s, China generally took a neutral standpoint and supported the decisions made by the UN Security Council. However, Beijing was seriously – and understandably – furious when the Chinese embassy in Belgrade was mistakenly bombed, during the 1999 NATO operation against the rump Yugoslav Federation.

Today, Beijing maintains diplomatic relations with all the WB6 members except for Kosovo. China opposed Kosovo's declaration of independence in 2008, and went as far as initiating a legal challenge against Pristina's decision in the International Court of Justice. Beijing's stance is shaped by concerns that Kosovo's recognition might set a precedent in relation to sensitive domestic issues, such as the restive regions of Tibet and Xinjiang. China's effective support for Serbia's position has been reciprocated, with Belgrade remaining strictly faithful to the One China policy, and, in a recent development, openly backing Beijing's position *vis-à-vis* territorial disputes in the South China Sea.

A flurry of infrastructure projects

China's increasingly active presence in central and eastern Europe, largely through the so-called '16+1' format, is part of Beijing's global 'going out' strategy. At the same time, this engagement has also been welcomed by the governments of these countries, as China pumps much-needed capital into national and regional economic development efforts. So far, the prime ministers of central and eastern European countries and China have held five annual summits, in Warsaw (2012), Prague (2013), Belgrade (2014), Suzhou (2015) and Riga (2016).

Beijing has announced a $10 billion credit line to support Chinese investment in the region, as well as a secretariat to facilitate cooperation and a commitment to two-way trade. In addition, the Chinese government has stated its aim to establish a $3 billion investment fund for the broader region, including the Western Balkans. It is expected that in a few years, China-funded transport infrastructure will criss-cross the southeast Europe, connecting ports, capitals and vital economic hubs.

In terms of project implementation, *Serbia* stands out once again as Beijing's key partner in the region. China has already invested more than $1 billion, mostly in the form of loans, to finance the building of transport infrastructure and energy projects in the country. For example, the Sino-Serbian Friendship Bridge across the Danube in Belgrade was a highly symbolic and visible project completed in 2014 to the tune of $260 million. The acquisition by the Chinese Hebei Iron and Steel Company (now the Hesteel Group) of a steel plant in Smederevo for €46 million was the largest foreign investment in Serbia in 2016, and Beijing has also signed an agreement for the construction of a Belgrade-Budapest high-speed railway.

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In *Montenegro*, the China Civil Engineering Construction Corporation is upgrading a 10km segment of the railway track connecting the port city of Bar on the Montenegrin coast with Belgrade, while the China Pacific Construction Group has signed a deal to construct a highway between Montenegro and Albania.

A €689 million loan provided by the state-owned Export-Import (Exim) Bank of China for the construction of the Podgorica-Kolasin motorway section is also worthy of note, as is the road linking Bar on the Adriatic Sea to the border with Serbia. Finally, another Exim Bank loan amounting to €56 million is earmarked for the construction of new ships by the Chinese Poly Group Corporation.

In *Bosnia and Herzegovina*, the construction of a motorway is being funded through Exim Bank loans, and, Chinese companies are currently developing two coal-fired thermal power plants, one in Stanari in the Republic of Srpska, and the other in Tuzla in the Federation of Bosnia and Herzegovina.

In *the former Yugoslav Republic of Macedonia*, China is half way through constructing two motorways, the Skopje-Shtip section in the eastern part of the country and the Kichevo-Ohrid one in the west.

The former Yugoslav Republic of Macedonia is very important in the context of China's BRI strategy, as the landlocked country sits on a prospective commercial route connecting the port facilities that the Chinese are operating in Piraeus (Greece) to Budapest (Hungary). This transport corridor is seen as the gateway to markets in central and western Europe.

Following the deal between Hungary, Serbia and China on upgrading the railway link between Budapest and Belgrade in January 2015, the former Yugoslav Republic of Macedonia and China agreed to prepare a feasibility study of the route and cost of modernising the country's railways. The next phase will involve defining models for financing the project, but it is worth noting that the China Railway Rolling Stock Corporation is already supplying Skopje with electric trains.

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Albania is an important piece of the Western Balkans puzzle for China, largely thanks to its location on the Adriatic coast – with a key position on the '21st Century Maritime Silk Road' (MSR) – and its considerable energy resources. For instance, the Shanghai-based Geo-Jade Petroleum Corporation has bought the controlling rights to two Albanian oil fields from a Canadian company for $442 million. In addition, Albania occupies a key spot along the Trans-Adriatic Pipeline, which is currently under construction. Once completed, it is to carry Caspian gas through Turkey, Greece and Albania to Italy and the rest of western Europe.

In December 2014, the Albanian government and the Exim Bank agreed to terms on the construction of the Arbër motorway, a stretch of road running to the former Yugoslav Republic of Macedonia and on to Bulgaria, thus linking the Ionian Sea and the Bulgarian part of the Black Sea coast. Last but not least, two Chinese companies, China Everbright and Friedmann Pacific Asset Management, have announced the acquisition of Tirana International Airport SHPK, which operates the Albanian capital's airport. The group will run the facility until 2025, with a two-year extension to 2027, subject to approval by the Albanian government.

What's in it for China?

At first glance, southeast Europe is not a particularly attractive market *per se*: the EU member states have been hit hard by the financial crisis, and the states of the Western Balkans are of limited size and lack purchasing power. But the fact is that the region can act as a major transport corridor for the BRI connecting the Mediterranean to central Europe.

The city of Piraeus in Greece is strategically located and is the fastest-growing port in Europe. To date, the China Ocean Shipping Company (COSCO) has invested $4.3 billion in harbour facilities and has recently acquired a controlling share in the port authority. Chinese officials are aiming to increase the port's container throughput to some 5 million 20ft container units by 2018, which would turn Piraeus into Europe's fifth-largest port.

This ambitious project clearly aims to help promote Chinese commodities in southeast and central Europe, particularly after the expansion of the capacity of the Suez Canal in August 2015. Notably, Piraeus has now overtaken Suez as the biggest COSCO installation outside China in terms of the number of containers handled. With the help of an upgraded Piraeus-Budapest transport corridor, containers from China will face a shorter and faster journey towards the heart of the continent, cutting at least ten days off the overall travel time to major sea ports in western Europe.

At the same time, it is clear that China is pursuing broader objectives related to the BRI initiative in the Western Balkans. Infrastructure projects in the region enable Chinese construction companies to acquire a track record in Europe, as well as help them mitigate their overcapacity challenges and create jobs for Chinese labourers. Last but not least, the region provides opportunities for the

Chinese government to invest excess capital, albeit to a limited degree.

Downsides and challenges

The template used by China in the Western Balkans is based on direct lending to governments for infrastructure development projects, be they roads, railways, ports or power plants. Typically, funding comes in the form of a loan from the Exim Bank covering about 85% of the project capital, with the rest financed by the recipient country. These loans are offered on favourable financial terms compared to most alternatives: they normally have a long maturity period (of around 20 years) and are subject to low interest rates (of around 2%).

However, while these conditions may seem attractive, the spillover to the rest of the economy is sometimes limited as Chinese companies often provide their own workers and supplies, and rarely rely on local resources. A study of loan practices by the China Development Bank and the Exim Bank in 2013-2015 showed that 70% of overseas credit was made on the condition that at least part of the funds are used to purchase Chinese equipment and involve Chinese labour.

In some cases, state-owned companies which obtain loans from China are contractually bound to work with Chinese subcontractors. In Serbia, Elektroprivreda Srbije's construction of a new block in the coal-fuelled Kostolac power plant is a case in point. Similarly, some 7,000 Chinese employees of the China Road and Bridge Corporation (CRBC) helped complete the Sino-Serbian Friendship Bridge. In other cases, Chinese-funded infrastructure projects have become marred by controversy. For instance, there is wide-spread suspicion that Sinohydro, the Chinese infrastructure giant, was awarded the contract to construct two highways in the former Yugoslav Republic of Macedonia through a tender which violated standard bidding procedures and allegedly granted the company certain (legally dubious) privileges.

Elsewhere, the Exim Bank has granted the Montenegrin government a €689 million loan for the Podgorica-Kolasin motorway construction project. As part of the terms and conditions of this 20-year loan (with a 6-year grace period and a 2% fixed interest rate), the Chinese construction company involved is exempted from taxes and custom fees. However, the project has been heavily criticised by opposition parties, which claim that the loan will substantially increase already high levels of public debt, and many even question the need to construct the motorway in the first place.

Non-calculated risks and delays also impede project implementation. In December 2014, the prime ministers of China, the former Yugoslav Republic of Macedonia, Serbia and Hungary signed an agreement on the construction of a high-speed railway line. However, contrary to initial expectations, the upgrading of the 340km Belgrade-Budapest railway is running behind schedule. Other parts of the prospective Piraeus-Budapest transport corridor are also proving to be problematic. Interestingly, COSCO has decided to stay out of the privatisation of TrainOSE, the operator of the Greek railway network. This may have to do with political uncertainty concerning the migrant crisis across the Balkans: in November 2015, for example, the railway track from Piraeus to the former Yugoslav Republic of Macedonia was blocked by a makeshift migrant camp in northern Greece for three weeks. Another blockade of the Greek section of the railway track lasted for more than two months, from mid-March to late May 2016. As a result, freight forwarders were forced to use the sea port of Koper in Slovenia and the Bulgarian railway network as alternative routes to central Europe.

Chinese authorities have not concealed their ambition to (re)establish Eurasia as the largest economic market in the world and to pursue a shift away from the dollar-based global financial system. In fact, the significance of Europe as a destination for Chinese commodities may further increase with Donald Trump in the White House. And China's growing presence could be beneficial for the Western Balkans to the extent that infrastructure development contributes to regional integration, increased trade flows and economic growth.

It will, however, take some time before the BRI routes through the Western Balkans constitute a *fully* operational transport network. In the meantime, there seems to be room for improvement in terms of project design and implementation modalities that are currently being used.

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