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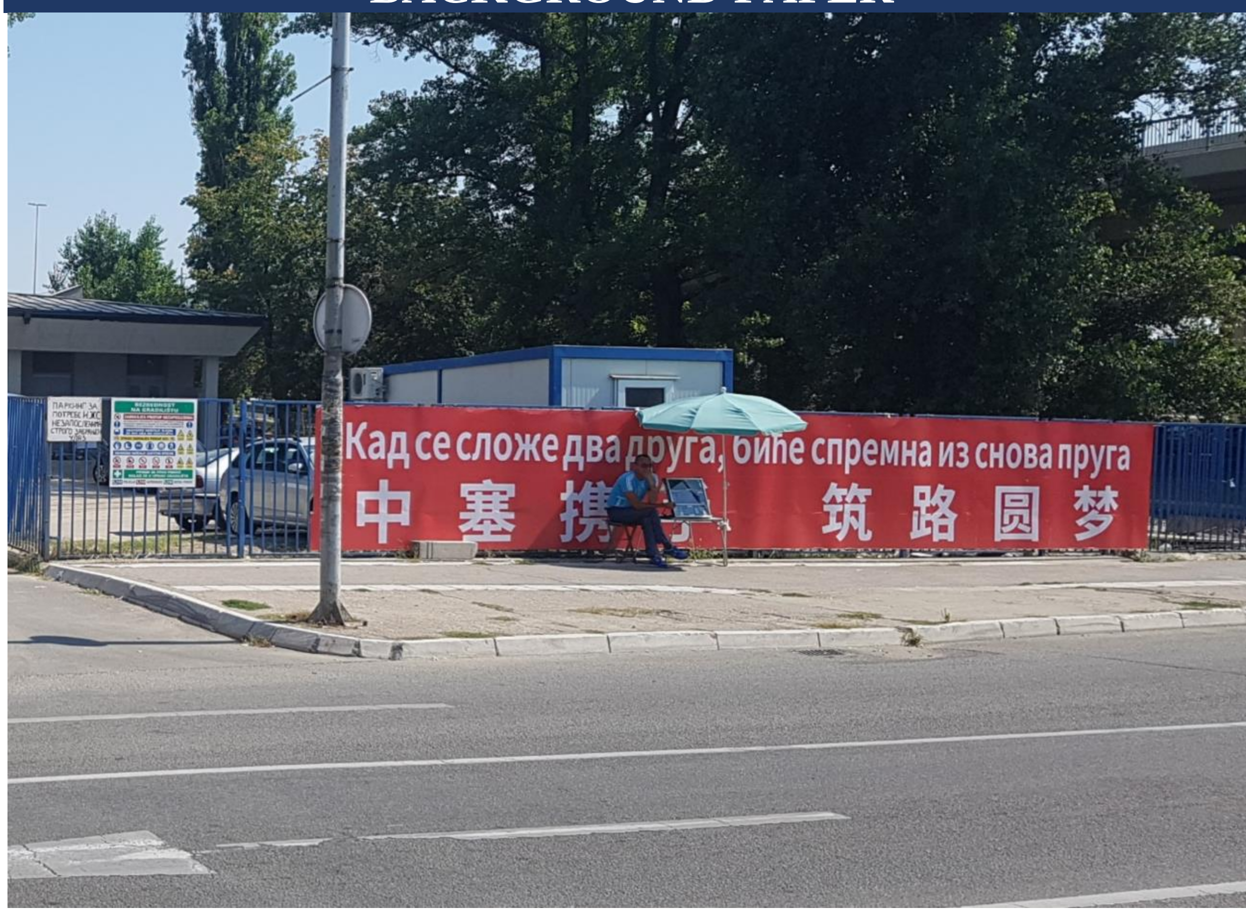
REALITY CHECK SERIES

SOURCES, TOOLS AND IMPACT OF EXTERNAL NON-EU-ENGAGEMENT IN SOUTHEASTERN EUROPE

PART III – **CHINA**

BACKGROUND PAPER



© Photo shows entrance to the construction site "Novi Beograd railway station" with a slogan in Serbian "When two friends join together, a dream-railway will be finished" and in Chinese "China and Serbia are joining together to build a railway that realizes dreams", courtesy of Sara Marencic.

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Southeast Europe in Current Chinese Foreign Economic Policy

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Executive Summary

Since 2013, China's signature foreign policy instrument – the Belt and Road Initiative (BRI) - is contributing to reshape the infrastructure landscape across continents, regions and countries. Southeast Europe is an integral part of this global endeavour. China is pro-actively investing in and lending to countries in the region. Supplementing these activities in bridge and motorway construction, railway modernization and equity investments in maritime ports and the energy sector are institutional arrangements such as the China-led 17+1 network and numerous soft-power initiatives like the Confucius Institutes emerging across Southeast Europe.

This background paper argues that China does *not* have a master plan for Southeast Europe. China's engagement in infrastructure development projects in the region is *not* a linear success story. Many projects either remain in the planning stage or never get off the ground; despite vibrant rhetoric. Others lack the appropriate financing arrangements, environmental impact assessment or economic viability. Chinese companies may submit bids, but also withdraw from tenders. Moreover, it is misleading to add the BRI label to every Chinese initiative. Some projects and acquisitions are older than the official inauguration of the BRI in 2013.

China is approaching each country in Southeast Europe on the basis of how it can individually contribute to the strategic interests of Chinese companies, Chinese government's policy banks and the foreign policy objectives of the political authorities in Beijing. In doing so, China is investing in and lending to countries in the region with a long-term perspective. There is little evidence that these activities are of a speculative nature. China will not leave the region on short notice. This development has major strategic implications for the European Union and other non-EU external actors such as Russia and Turkey who are also engaged in Southeast Europe.

For five of the six countries in the Western Balkans, the expanding footprint of China presents unique challenges and opportunities. Albania, Bosnia and Hercegovina, Montenegro, North Macedonia and Serbia have received varying amounts of investments and lending, initially to finance and construct large-scale infrastructure projects. But not all countries in the region are treated equally. Serbia stands out as a prime destination of Chinese investment. By contrast, Kosovo does not feature on the map of Chinese interests. The reason is not the size of the country, but Beijing's refusal to recognize Kosovo's political independence.

As the country cases in this background paper illustrate, clear rules of engagement with Chinese companies, banks and political interlocutors are in growing demand but low supply. Countries in Southeast Europe are only gradually starting to define what precisely they want from China. While many bilateral Memorandums of Understanding (MoUs) are being signed, strategic blueprints setting out a country's policy priorities vis-à-vis China are still hard to identify. But the empirical experience acquired as well as the lessons learned in the course of the past five years are yielding a greater emphasis on the need for capacity building, the formulation of feasibility studies and a deeper understanding of the complex financial arrangements. In a word, while countries in Southeast Europe are learning from their engagement with China, the same also holds in reverse: China is adopting lessons learned from its expanding involvement in the region.

China is becoming an important player in Southeast Europe. This development requires strategic adjustments and new policy initiatives by the EU as illustrated in this background paper. Beijing's activities in the region also mobilize the foreign policy apparatuses of Russia and Turkey. In short, China is in play in Southeast Europe and is there to stay for the long-term.

Introduction

The following *Background Paper* was prepared on the basis of guidelines provided by the *Southeast Europe Association* (SOG) in Munich, Germany.[1] The rationale of this contribution is to serve as background information for the international conference: "*Reality Check Series: Sources, Tools and Impact of External Non-EU-Engagement in Southeastern Europe. Part III: China*". The conference is held in Berlin on 28-29th November 2019.

The third installment of the conference series – after Russia and subsequently Turkey - focuses on China's growing footprint in the region of Southeast Europe.[2] As an emboldened China becomes more assertive on the global political economy stage, individual countries are being challenged to re-define their strategic priorities vis-à-vis Beijing. For EU member states from Central, Eastern and Southeast Europe and EU candidate countries from the Western Balkans China's investment and lending outreach raises profound questions concerning the political standards, rules of engagement and objectives of bilateral cooperation.

China's flagship foreign policy project is the Belt and Road Initiative (BRI).[3] Since its official launch in 2013 by President Xi Jinping the BRI invests on a global scale in land-based and maritime projects, primarily through transport connectivity and trade enhancing infrastructure. Under the aegis of the BRI promises of "shared prosperity" are promoted to participating countries. China's BRI combines unprecedented amounts of investments and loan funding for ambitious infrastructure projects across continents, regions and individual countries. Beijing-based policy banks are the primary providers of funding arrangements for these projects.

For the European Commission in Brussels and individual EU member states the BRI raises profound questions concerning their political relationship with China. While the Commission seeks to develop a coherent strategy vis-à-vis China's BRI ambitions, Beijing is busy offering loan facilities, Chinese labour and services for the construction of bridges, highways and the modernization of ports and railways across Europe. The ability of the EU to speak with one voice in negotiations with China is being challenged through institutional settings such as the 17+1 network of countries from Central, Eastern and Southeast Europe cooperating with Beijing.

The utility of the BRI is an ambitious but at the same time contentious work in progress. It will extend only as far as it is able to generate tangible and sustainable outcomes benefiting not only China but also participating countries who engage in this endeavor. China's reach into Southeast Europe is taking place because it sees value there and attracts political interest from decision makers. As Christine Lagarde, the former *International Monetary Fund* Managing Director (IMF until September 2019) remarked in April 2019 in Beijing, "to be fully successful, the Belt and Road should only go where it is needed. I would add… that it should only go where it is

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[1] In writing this background paper I would like to thank Johanna Deimel, Andreas Wildermuth and Michael Weichert for useful information on past and current Chinese activities in Southeast Europe.

[2] The region of Southeast Europe comprises 16 countries which the SOG identifies as: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Greece, Hungary, Kosovo, North Macedonia, Moldova, Montenegro, Romania, Serbia, Slovakia, Slovenia and Turkey.

[3] A word about terminology needs to be clarified from the outset. Since its inception by President Xi Jinping in 2013, China's representatives use the term *One Belt – One Road* (OBOR). The term *Belt and Road Initiative* (BRI) introduced in 2016 is a linguistic compromise and cosmetic adjustment to the English language. For our analysis we shall use the BRI terminology.

sustainable" (Reuters 2019). The mixture of infrastructure projects is there for citizens in Southeast Europe to see. Chinese companies choose where their impact will create visibility on the ground.

At the second *Belt and Road Forum* (BRF) held in Beijing in April 2019, China's President Xi Jinping stipulated that since the BRI was officially launched in 2013 China had signed more than 170 BRI-related agreements with more than 125 countries. The 2019 Forum was attended by heads of state and government from 37 countries, including Russian President Vladimir Putin, Italian Prime Minister Giuseppe Conte, President Aleksandar Vučić from Serbia as well as the prime ministers from Greece (then Alexis Tsipras) and Hungary, Viktor Orbán.[4] But the list of attendees was also noteworthy for who was not attending the second BRF. India did not send a delegation. Neither did Turkey, nor Spain. Somewhat surprisingly, Poland, which is a member of the China-led 17+1 network, did not participate in the second BRF. In light of the protracted trade disputes between Washington and Beijing, the Trump administration only sent a low-level delegation.

I. Goals, tools and actors of China's policy in Southeast Europe

How do Chinese political authorities frame the BRI in Southeast Europe? When Chinese representatives visit the region they regularly emphasize how "to dovetail" the Belt and Road Initiative with the development strategies of participating countries in the region. The individual country cases in section II will provide examples of such dovetailing. Today, few political leaders in the region and representatives from the corporate sector name Moscow or Ankara as a model. Increasingly Beijing is becoming a magnet for decision makers in Southeast Europe. The radical transformation of China over the past four decades is universally acknowledged - and frequently applauded - by policy makers in the region. To illustrate, consider the following assessment by the Montenegrin President Milo Djukanovic in September 2019:

> "*I believe that reforms and the policy of open doors, as well as integration into the world economy, have greatly contributed to China's success. Therefore, I consider China's spectacular rapid development a just thing. ... China has really shown that it has founded its vision of development on reforms and openness, as well as a flawless analysis of the social circumstances in China itself, and it clearly saw its opportunities, possibilities, needs and wishes"*. Mr. Djukanovic went on to emphasize that Montenegro has seen opportunities for its own development in cooperation with China under the BRI. He regards the BRI as an opportunity to help *"harness resources fully, faster and smarter and improve the standard of living of its people*" (Xinhua News Agency 2019a, emphasis added, J.B.).

Demonstratively praising China in these terms is not uncommon among political leaders in Southeast Europe. Such cheer leading reflects expectations of increased investment capital inflows, lending for ambitious infrastructure projects and improved commercial access to the Chinese market, i.e. export capacity from the region to China (Tonchev 2019a). When the Chinese Premier Li Keqiang visited Dubrovnik in April 2019 to attend the 9th China-Central and Eastern European Countries (CEEC) Business Forum, he underlined the momentum of economic and commercial cooperation within the so-called 17+1 network (China.org.cn 2019).

- In 2018, China's trade with the Central and East European (CEE) countries increased by 21 percent, reaching a record high of 82.2 billion U.S. dollars;

[4] A total of seven EU Member States were represented at the Forum through their Prime Minister (Austria, Greece, Hungary and Italy) or President (the Czech Republic, Cyprus and Portugal).

- Growth of China's imports from CEE countries outpaced that of exports by five percentage points;
- China's investment in CEE countries increased by 67 percent in 2018;
- Investments are most prominent in the energy, mining and home appliance sectors;
- There were over 1.4 million tourist arrivals from China to CEE countries in 2018 while 350.000 visitors came from CEE countries to China;
- China is using a growing variety of financing institutions to secure the flow of credit for major infrastructure projects and acquisitions in Southeast Europe. State-owned policy banks (e.g. *China Development Bank* and *Exim Bank of China*), the China-led *Asian Infrastructure Investment Bank* (AIIB), the *Silk Road Fund*, and the *China-CEEC Inter-Bank Association* highlight the diversity of Chinese [backed] financing institutions that are active in the region.

These various economic, commercial and financial sector developments highlight an emerging reality in Southeast Europe: China matters to the region. But make no mistake about country-specific differences. Some are more equal than others. Greece and Serbia stand out as the flag bearers of Chinese *investments*, while *lending* for infrastructure projects has targeted Montenegro, Bosnia and Hercegovina as well as North Macedonia. The outlier is Kosovo which is not on the map of Chinese activities in the region. China has steadfastly refused to recognize the sovereignty of Kosovo, thus siding with Serbia.

The flip side of this argument also holds, namely that the region of Southeast Europe is of growing economic, commercial and strategic importance for China. Apart from the numerous infrastructure projects, the most visible sign of this importance is the effort China has put into establishing and subsequently enlarging an institutional architecture for bilateral cooperation under the heading "17+1 framework". Section IV discusses this development and its implications in greater detail.

Shifting arbitration and mediation to China

A new instrument in the BRI-toolbox concerns Beijing's endeavour to shift bilateral legal disputes towards China. In the course of 2018 arbitration procedures and the legal dispute resolution of contracts based on the BRI are gradually being relocated to China and administered according to Chinese law. More specifically, China's expanding footprint in BRI dispute resolution is illustrated by establishing two new international commercial courts (Yang 2018). In June 2018, China's *Supreme Peoples' Court* established these new legal institutions:

- In Xi'an (the capital city in the province of Shaanxi) for the land-based Silk Road Economic Belt;
- In Shenzhen (in the province of Guangdong) for the Maritime Silk Road.

China argued that both courts are necessary to address the growing number of legal cases that have arisen in the context of the BRI's expansion. These novel courts will be providing litigation, arbitration and mediation services. The objective for China is to have all BRI related disputes resolved in these courts and based on Chinese jurisprudence. The two courts will only deal with legal cases between businesses and investors. BRI-related disputes between states or between investors and states are *not* [yet] part of the new courts' jurisdiction. The judges assigned to both courts are nominated by the Supreme Peoples' Court. This arrangement integrates the new courts into China's legal and judicial system. However, this system cannot be viewed as independent from the political authorities in Beijing. Both new courts therefore face the suspicion that Chinese judges will not act impartially.

Given the fact that most BRI-projects are internationally intertwined, the courts in Xi'an and Shenzhen have the discretion to process mediation and arbitration cases with the assistance of existing international dispute resolution institutions. This may include the *London Court of International Arbitration* and the *International Arbitration Centre* located in Hong Kong. Furthermore, international commercial cases are administered by the *Singapore International Commercial Court* and the *International Finance Centre Courts* in Dubai.

Foreign litigants continue to have the right to choose between the international or the Chinese location for dispute resolution. But this option faces the following risk: Chinese companies involved in any BRI-related legal complaint can be expected to prefer the newly created courts in China. This preference may already be included in the contractual arrangements stipulating the financial, operational and legal details of any bilateral BRI project. In a word, China is gradually developing its own cross-border system of BRI jurisdiction. This development will present major legal, operational and administrative challenges for EU member states in Southeast Europe, and even more so for EU candidate and accession countries in the Western Balkans.

Soft Power Capacity

The American political scientist Joseph S. Nye is regularly associated with the terminology of *soft power*. As a matter of fact, the phrase he coined in the late 1980s was originally introduced as "soft co-optive power" (Nye 1990). Thereby, the Harvard-based professor described the ability of a country's culture and political ideals to influence other countries and its citizenry. Back then, the country Prof. Nye had in mind was not China, but the United States and its capacity to win hearts and minds. In 2015, Nye had begun to reverse his view on Washington's soft power capacity. He pointedly asked (Nye 2015) if the American century was over and highlighted the rise of China. As Nye has remarked, soft power is hard to measure in quantitative terms. But there are institutional markers which help in identifying such capacity.

With the view to promoting cultural diplomacy in more than 140 countries worldwide, China has established a network of *Confucius Institutes* (CIs) on university and college campuses. The mandate of these non-profit cultural centers is to highlight the Confucian heritage, promoting Chinese language(s) and present the diversity of its many cultures. There are currently 23 such CIs across Southeast Europe (see table 1 next page). The first was created in Serbia in 2006. Romania stands out with a total of four such CIs, followed by Hungary and Turkey with three each, respectively. Again, only Kosovo does not feature a Confucius Institute. All of these Confucius Institutes are located at universities across the region. The Institutes are administered by *Hanban*, a division of China's education ministry. Hanban pays for the Institutes' operational costs, selects textbooks and hires, trains and pays for Chinese language teachers in Southeast Europe.

The spreading presence of Confucius Institutes across Southeast Europe's university landscape is also important for another reason. They should not only be viewed as a network of language institutes and staging cultural events. They can also serve as influence agencies to advance messages and developments important to China's political authorities. The CIs frequently invite university academics from China to explain Beijing's reasoning behind the BRI. They proclaim all the right notes about peace, multicultural dialog and mutual prosperity.

Visiting Chinese diplomats and academics regularly address the BRI in the context of terminology such as "*win-win cooperation*" "*community of a shared future for mankind*" and "*the democratization of international relations*". Such ambiguous rhetoric seeks to underline that the joint ventures are presumably partnerships of equals with no strings attached and that they do not correspond to infrastructure initiatives with Chinese characteristics.

Table 1 China's Soft Power Footprint in Southeast Europe – Confucius Institutes

Country	**Location**	**Year**
Serbia	University of Belgrade, University of Novi Sad	May 2006
Bulgaria	Sofia University	June 2006
	St. Cyril + St. Methodius Veliko Turnovo University	October 2012
Hungary	Eotvos Lorand University	September 2006
	University of Miskolc	December 2011
	University of Szeged	Autumn 2012
Slovakia	Slovak University of Technology	May 2007
Turkey	Bogazici University	March 2008
	Middle East Technical University	November 2008
	Okan University	June 2012
Greece	Athens University of Economics and Business	June 2008
	University of Thessalia, Thessaloniki	November 2019
Slovenia	University of Ljubljana	August 2009
Moldova	Free International University	September 2009
Romania	Babeş-Bolyai University of Cluj-Napoca	October 2009
	Transilvania University of Brasov	March 2012
	Lucian Blaga University of Sibiu	September 2013
	University of Bucharest	November 2013
Croatia	University of Zagreb	July 2011
North Macedonia	SS Cyril and Methodius University	April 2013
Albania	University of Tirana	June 2013
Montenegro	University of Montenegro	September 2014
Cyprus	University of Cyprus	September 2014
Bosnia and Herzegovina	University of Sarajevo	December 2014

Source: Compilation by the author. The list is structured by chronological order, i.e. when the first Confucius Institute was established in the respective countries of Southeast Europe. The compilation is based on "Confucius Institutes Around the World – 2019" (Digmandarin 2019).

The soft power capacity of China's footprint in Central, Eastern and Southeast Europe extends beyond the Confucius Institutes. China is also funding research institutes and think tanks "with Chinese characteristics", university chairs and scholarships for university studies of citizens from countries in Southeast Europe in China. In April 2017 the *Chinese Academy for Social Sciences* (CASS) established the *China-CEE Institute*, a think-tank based in Budapest, Hungary. It is China's first think tank created in Europe. The Institute is registered as a non-profit corporation. The China-CEE Institute seeks to build ties and strengthen partnerships with academic institutions and think tanks in Hungary and other Central and Eastern European countries. In September 2015 a second Chinese think tank was established in the Czech Republic. The *New Silk Road Institute Prague* seeks to strengthen ties between Asia and Europe. Like its peer in Budapest, the Prague Institute is registered as a nonprofit charitable organization.

In October 2015 the *Silk Road Think Tank Network* (SiLKS) was launched to provide intellectual support to the Belt and Road Initiative. SiLKS defines itself as an informal international network that was initiated jointly by think tanks, international organizations, and relevant institutions from more than thirty countries. It focuses on BRI-related research, information and knowledge sharing as well as capacity development on policy research and consultation. Among the 55 international members and partners from 27 countries (March 2019) are also four participating think tanks from the region, namely:

- The Center for International Relations and Sustainable Development (CIRSD) in Serbia;
- The Center for Strategic Research of the Ministry of Foreign Affairs of the Republic of Turkey (SAM);
- The Geoeconomic Forum of Croatia;
- Századvég School of Politics Foundation in Budapest.

At the bilateral level, Sino-Southeast European scientific and academic cooperation is equally making inroads. The *Montenegrin Academy of Sciences and Arts* (MASA) and the *Chinese Academy for Social Sciences* (CASS) signed a cooperation agreement in September 2019. The agreement calls for the two academies to enhance bilateral partnership through the exchange of scholars, joint conferences and cooperative research projects in the fields of natural sciences and technology. MASA was also invited to apply for membership in the newly established *Alliance of International Science Organizations (*ANSO), which was initiated by CASS and 36 other Chinese research institutions in November 2017 to promote global scientific and technological cooperation.

In individual countries of the Western Balkans China is also establishing – with the assistance of local partners – so-called "*Centers for Promotion and Development of the Initiative "One Belt and One Road*". These centers serve to highlight Chinese policy initiatives in the host country, areas of potential cooperation and give Beijing's diplomats a platform to interact with civil society representatives (Tonchev 2019b). In other countries, such soft power institutions take the form of "*One Belt One Road" Trade and Investment Promotion Centres*, as is the case in Belgrade in cooperation with the *Serbia Chamber of Commerce and Industry*.

In Bosnia and Herzegovina bilateral soft power institutions operate under the heading the *Bosnia-China Friendship Association* and the *BiH Belt and Road Construction and Promotion Center*. These associations and/or centers organize seminars for the political, academic, business, and media sectors with the frequent participation of the Chinese ambassador in Sarajevo. They serve to exchange views on current and future BiH-China relations, highlight the development potential brought by the Belt and Road Initiative, and never forget to emphasize that participating countries should not miss these opportunities provided by China (Xinhua News Agency 2019b).

II. Country cases

What characterizes China's relations to individual countries in Southeast Europe? The following country case studies are introduced in order to highlight their relevance to Chinese policy in the region. It is important to underline that China's overtures in the region distinguishes between *equity investments* in companies and *concessionary lending* to governments for the construction of infrastructure projects. Concessionary lending defines loans that are extended on terms substantially more generous than market loans. The concessionary element can be achieved through interest rates below those available on private capital markets, by grace periods, or a combination of both factors. This background paper argues that lending by Chinese banks does *not* qualify as foreign direct investment in Southeast European countries.

We first focus on two EU member states, namely Greece and Hungary. We then turn our attention to the situation in six countries in the Western Balkans. Given limitation of space, China's growing footprint in these countries cannot be elaborated in every detail. Instead, we present recent developments (primarily from 2018 and 2019). These examples serve to underscore what China is doing, for what reason this is taking place, and what means Beijing is applying to implement its strategic objectives, e.g. in terms of equity investments or lending for infrastructure projects.

Greece: The Gateway to Europe?

During his visit to Athens and the Port of Piraeus in June 2014, the Chinese Premier Li Keqiang called Greece "China's Gateway to Europe" (Maltezou 2014). Five years later, the Greek minister for development and investments, Adonis Georgiadis, took stock of Sino-Greek relations:

> *"We really admire China here* [in Greece, added by J.B.]; *it is one of the biggest investors in Greece and in the last 10 years we made many success stories together. Even more Chinese investments would be very welcome"* (Kathimerini 2019).

Such ambitious rhetoric is backed-up by facts on the ground. The gateway's first opening concerned the Chinese shipping group COSCO's (*Chinese Ocean Shipping Company*) decision in 2009 to lease container terminals in Piraeus under a 35-year concession agreement with the Greek government. This anchor investment subsequently led to COSCO becoming the majority owner (51 percent) of the *Piraeus Port Authority* (OLP), the management company responsible for the operation of the entire Port of Piraeus in April 2016.[5]

In September 2019, the *Port Planning and Development Commission* (ESAL) of the new government of Prime Minister Kyriakos Mitsotakis[6] approved COSCO's proposed 800-million-euro investment plan in the Port of Piraeus. COSCO's master plan includes the construction of a

[5] Based on mandatory investment benchmarks COSCO reserved the right to acquire a further 16 percent of OLP by 2021. The price for the 51 percent shareholding was €280.5 million. The additional 16 percent can be acquired for €88 million. In 2016, COSCO had one competitor in the tender, *Maersk* from Denmark.
[6] The general elections in July 2019 resulted in a landslide victory for the largest opposition party *New Democracy* which was able to form a single-party government with an absolute majority. The ESAL is subordinate to the Ministry of Shipping.

fourth container terminal[7], the transformation of the dock used for ship repairs into a new car terminal, enlargement of the cruise passenger terminal, additional storage facilities, four hotels, a logistics and a commercial centre. On the occasion of his state visit to Greece in November 2019, the Chinese President Xi Jinping referred to COSCO'S expanding presence in the port as "the dragon's head". In a word, COSCO's involvement in the Port of Piraeus is long-term, with clear strategic objectives and the capacity to mobilize considerable investment volumes. This engagement has positive knock-on effects in the wider Athens area. It also impacts on Greece's real economy, the shipping sector, the labour market, tourism and commercial trade.

What can we learn from this extraordinary Sino-Greek cooperation during the past decade?

- COSCO's investment in the Port of Piraeus is part of the group's growing shipping portfolio in Europe and China's increasing importance in shipping finance. COSCO is building global maritime supply chains in which Piraeus plays a central connectivity role. Leasing constituted the initial investment in Greece. Today the financing profile of COSCO's acquisitions is characterized by majority and minority shareholdings in numerous European ports (Bastian 2019).
- COSCO's master plan for Piraeus is integrated into a wider policy agenda of Chinese shipping. Enlarging maritime connectivity for the Chinese merchant fleet seeks not only to increase trade flows, but also to better control trade routes and port access. Building maritime infrastructure across Europe gives China leverage over land-based interconnectivity and corresponding supply chains (Marantidou 2018).
- Since 2013 Greece has – like other EU member states – a so-called 'Golden Visa' programme'. It offers a five-year renewable residency permit to non-EU citizens who invest at least 250.000 euros in local real estate. The programme does *not* require a continued physical presence in Greece. Chinese citizens are the single-largest constituency purchasing property in Greece. Of the 5.302 Golden Visas issued in Greece between mid-2013 and October 2019, a total of 3.464 (or 66 percent!) were issued to Chinese citizens (Naftemporiki 2019).[8]
- Not only Greek shipowners are seeking close cooperation with China. The anchor investment in the Port of Piraeus served as a catalyst for follow-up investments in other sectors. Sino-Greek joint ventures are now taking place in the energy sector, tourism, real estate and most recently investment in Artificial Intelligence (A.I.). In June 2019, the Chinese AI company *DeepBlue Technology* announced that it will establish an innovation channel between Greece and China. DeepBlue is the world's largest AI application development company. In cooperation with Thessaloniki's Aristotle University, DeepBlue will build an AI innovation hub in Greece.

Greece's growing partnership with China also has political consequences. In 2018, Greece applied to join the then-existing 16+1 network (for more details see section IV). On the occasion of the

[7] If and when the fourth container terminal will be built remains to be seen. While the Greek government supports COSCO's intention, there is opposition from municipal councils in Piraeus, trade unions representing metal workers in the port and from ship repair companies. This opposition has frozen parts of COSCO's master plan and reduces the total investment volume by approximately 300 million euro.

[8] Such investor citizenship or residence schemes have grown considerably in the EU during the past decade. Today, 20 out of 28 EU member states operate such schemes. The European Commission is increasingly and critically taking note of these schemes, not least regarding allegations of money laundering, fraud and tax evasion (European Commission 2019a).

annual CEEC-China summit in Dubrovnik on the Adriatic Sea in Croatia, Greece was admitted as the seventeenth European member, thereby changing the name of the network to "17+1". Greece's membership in the network was driven by the then Greek Prime Minister Alexis Tsipras. While he raised eyebrows in Brussels, Berlin and Paris for this move, Tsipras received by-partisan political support in Greece on the subject matter of greater Sino-Greek cooperation in platforms such as the 17+1 network.

Hungary: The perils of railway modernization

The flagship project along the BRI rail route in Southeast Europe concerns the modernisation of a China-financed cross-border high-speed railway connection between Budapest and Belgrade. When completed the new rail link would carry Chinese goods that arrive by sea at the Port of Piraeus and are then transferred by rail to countries in the Western Balkans as well as other parts of Europe. The trilateral profile of the project involves the EU member state Hungary, the EU candidate country Serbia, and in the middle China as a non-EU external actor. This combination of countries in a European cross-border rail project attracted considerable attention by the Commission in Brussels. There is also a larger political economy dimension in this flagship infrastructure development project. Hungary's Prime Minister Viktor Orbán highlighted this dimension at the opening of the China – Central and Eastern Europe Summit in Budapest in 2017:

> "*Globalization's new world order has also brought new configurations. We look upon the President of China's One Belt One Road Initiative as one of globalisation's new configurations: one which will no longer divide the world into teachers and students, but which will provide the basis for mutual respect and mutual advantage*" (The Hungarian Government 2017).

The initial Memorandum of Understanding (MoU) between Hungary, China and Serbia was signed in December 2014. The construction contract for the Hungarian part of the project was then awarded in a non-competitive bid to the *China Railway International Corp.*, the state-owned Chinese rail company. According to government representatives in Budapest, Hungarian law permits no-bid contracting when public land is involved and the investment results in wider economic benefits.

For both Hungary and Serbia such a project had been on and off the infrastructure agenda for more than a decade. But it failed to progress, primarily for the lack of financing capacity of both countries. In November 2016, China's *Exim Ban*k agreed to fund 85 per cent of the Hungarian route of the railway project. The construction of the Hungarian stretch is budgeted at approximately 550 billion forints (USD 2.1 billion). The duration of the credit line is for 20 years and the annual interest rate fixed at 2.5 per cent. Prime Minister Orbán asserted the need for the Belgrade-Budapest railway project, and for Chinese investment in general, as follows:

> "*We need to carry out numerous investments for which* ***there is not enough capital*** **in the Hungarian economy or** ***in the European Union***...That is why ***we are financing the Budapest-Belgrade railway line with Chinese assistance***" (GCR 2017, emphasis added).[9]

[9] Hungary has positioned itself as the financial hub for Chinese banks. The *Bank of China* has its regional headquarters in Budapest. China has also opened a European clearing center for its currency, the renminbi. In 2016, Hungary became the first country in the region to issue a renminbi-denominated sovereign bond.

In January 2017, the European Commission launched a preliminary investigation into the landmark railway project against Hungary. The infringement proceedings focused on procurement procedures and financial arrangements on the Hungarian side of the rail project. The probe contended that Hungary was in breach of EU procurement laws by not initiating a proper public tender for a transport project of such a financial magnitude. The allegation of having violated EU procurement rules was a serious matter, both for the political authorities in Budapest as much as for the reputational capital that Chinese companies are seeking to build vis-à-vis EU institutions.

It is instructive to see what happened next. In reaction to the Commission's inquiry the Hungarian authorities relaunched a formal procurement tender for the 152-kilometer route from Budapest to the border crossing with Serbia in November 2017. On the occasion of the *Central and Eastern Europe – China Summit* in Budapest, the Hungarian minister for foreign affairs and trade, Péter Szijjártó argued that the winning bid would sign an EPC contract (engineering, procurement, construction) with the *Chinese-Hungarian Railway Nonprofit Ltd.* The joint venture includes the Hungarian state railway *MAV* with 15 per cent and two Chinese companies, the *China Railway International Corporation* and the *China Railway International Group* holding 85 per cent of the equity. The joint venture was established in October 2016.

In June 2019, the public tender was won by a Hungarian-Chinese group. The new contract was awarded to the *CRE Consortium*, half of which is owned by a unit of the Hungarian holding company *Opus Global* (RM International Zrt.). The Chinese half of the consortium is owned by *China Tiejiuju Engineering & Construction Kft.* and *China Railway Electrification Engineering Group Kft.*, representing the Chinese state railways company. The five-year construction period is to start in the third quarter of 2019, provided the financing arrangements with *Exim Bank* can be finalized within the context of the new contract specifications.

What can we learn from this series of events in a flagship infrastructure project that involves an EU member state, an EU candidate country negotiating accession chapters with the Commission in Brussels and China linking both countries?

- For one, as Hungary faced an infringement procedure by the Commission against EU law it swiftly agreed to compromise and proceed in compliance with public procurement regulations defined in and monitored by Brussels. Apart from considerable financial risks, reputational capital was at stake for China, too. It was in the joint interest of Budapest *and* Beijing to engage in railway diplomacy and seek a fast-track resolution instead of drawn out legal proceedings with the authorities in Brussels.

- Secondly, the case illustrates that the regulatory arm of the Commission can be long and strong. Cross border BRI infrastructure projects involving an EU member state and an EU candidate country risk triggering investigations by the Commission if doubts over tender procedures or non-transparent financing arrangements surface. Put otherwise, the regulatory toolbox which the Commission had at its disposal proved that it has teeth that can bite. As a matter of urgency both Budapest and Beijing agreed to settle the procurement issue as required by EU rules and legislation.

Serbia: A Gateway Between East and West?

Serbia is increasingly becoming the gateway for non-EU external actors to the Western Balkans. Five years ago, the Serbian President Aleksandar Vučić characterized his country as "well placed to become the gateway between East and West" (FT 2014). As a land-locked country, the establishment of such a gateway architecture requires considerable investments which Serbia cannot mobilize, let alone finance itself. Since 2015, China has invested in and provided loan facilities to Belgrade for the construction and financing of major infrastructure projects.[10] To illustrate this dynamic, consider the following examples between 2017 and 2019:

- In May 2017, Serbia agreed to borrow USD 298 million from China's *Exim Bank* to finance the first components of the construction works of the Belgrade – Budapest railway project (Garcevic 2018). The ceremonial start of the Serbian stretch took place in November 2017 in Belgrade's Zemun neighborhood. It includes the construction of a 34 km new line to the northern town of Stara-Pazova by *China Railway International*. Seen in conjunction with the credit line provided by *Exim Bank* of China, both the contractor and the financier of the project are not (!) from Serbia.
- A characteristic of China's expanding equity footprint in Serbia concerns the energy sector. The Chinese *Zijin Mining Company* – third-largest copper and gold producer in China – was chosen by the Serbian government in August 2018 in an open tender process to acquire the *Rudarsko Topionicarski Basen Bor* (RTB Bor) copper mining and smelting complex. Zijin acquired a 63-percent stake in the complex located in eastern Serbia for USD 1.26 billion. According to Serbia's Minister of Energy and Mining Aleksandar Antic, Zijin promised to cover RTB Bor's USD 200 million debt and keep 5,000 jobs at the mine.
- With this acquisition, the Chinese Zijin Mining company is investing almost USD 3 billion to stake major claims in the Serbian copper industry. The RTB Bor equity investment represents back-to-back mining transactions by Zijin in Serbia. In October 2018, Zijin acquired the Canadian base metals producer *Nevsun Resources* for USD 1.4 billion. The acquisition included the *Timok* copper-gold mining exploration in Cukar Peki near Bor.
- Fujian-based *Zijin Mining Company* has energy interests around the world. The unprecedented element in Zijin's RTB Bor's acquisition is the fact that it submitted the winning bid in the final stage of the tender process against a Russian competitor, *U Gold*. Despite strong political economy ties with Russia, the government in Belgrade opted for the Chinese company as it pledged more follow-up investment after the acquisition.
- In the Belgrade suburb of Borca the *China Road and Bridge Corporation* (CRBC) has agreed to build the first industrial park in Serbia. CRBC's total investment of 220 million euro is financed by a consortium of three Chinese banks, namely *Export-Import Bank*, *China Development Bank* (CDB) and *China Construction Bank* (CCB). Various Chinese firms have expressed an interest in launching production facilities once the industrial park opens its gates in 2021. According to Nenad Popovic, Serbia's minister for innovation and

[10] To lend symbolic credence to this "gateway" rhetoric, China financed and built the *Pupin Bridge*, named after the Serbian scientist and inventor Mihajlo Pupin. The road bridge over the Danube River in Belgrade is also called the 'Friendship Bridge' between Serbia and China. It was inaugurated in December 2014. The Pupin Bridge was the first bridge project that China completed in Southeast Europe. The lead construction company was *China Road and Bridge Corporation* (CRBC).

technology the business plan for the construction of the industrial park stipulates that up to 70 percent of the employees to be hired, the materials that will be procured and subcontractors involved have to be from Serbia (Industry Europe 2019).

Why is China investing such large amounts in the Serbian mining sector?
One answer can be found in industrial policy making priorities in China. Zijin Mining is focusing on the resource-abundant area in eastern Serbia. It is doing so because of the growing demand from China's *New Energy Vehicle* sector (NEV). This sector includes vehicles that are powered by electricity. The production of batteries for NEV cars, buses and trucks requires copper and zinc. Seen in this context, Chinese companies are establishing supply chain networks in Serbia in order to advance the execution of industrial policy objectives in China. RTB Bor and Timok are the second and third mining companies Chinese firms bought in Serbia. Already in 2016, China's *Hebei Iron and Steel Group* (HBIS) acquired *Zelezara Smederevo*, a loss-making steel plant which is being extensively restructured through technology transfers from China to Serbia.

A further reason for Serbia's openness towards China is the willingness of the government in Beijing to be as accommodating as possible while driving a hard bargain. This approach is much appreciated in Belgrade, as the following statement from Serbia's minister responsible for innovation and technology, Nenad Popovic, underlines: "*Western countries' investment in Serbia usually has strings attached, but China's investment never does*" (China Daily 2019). This widening Sino-Serbian economic engagement is also reflected at the political level. Since 2017, both countries have established a visa-free regime and in 2018 the bilateral relationship was elevated to a "comprehensive strategic partnership".

Montenegro: Entrapped in Debt?

China's cooperation with Montenegro dates back years *before* the BRI became official policy of Beijing. This initial cooperation primarily focused on energy policy, specifically hydroelectric power plant construction. Following Montenegro's independence in May 2006, the former state power monopoly, *Elektroprivreda Crne Gore* (EPCG) developed ambitious new generation energy infrastructure plans for the country.[11] The blueprint would not only meet Montenegro's immediate power needs but also projected energy exports to neighboring countries. In 2010 the Government of Montenegro approved the construction of a four-cascade dam on the Moraca River. The dam included the construction of four hydropower plants - HPP Andrijevo, HPP Raslovići, HPP Milunovići and HPP Zlatica. The government offered the plants on a build-operate-transfer basis, giving investors a 30-year concession to operate them. The construction costs were estimated at 540 million euro. Two Chinese companies were in advanced negotiations with the authorities in Podgorica, namely *Shanghai Electric Corporation* and *Sinohydro Corporation Ltd*. However, neither company submitted binding offers in the Moraca tender process, citing doubts about its economic sustainability.

This initial failure did not discourage Chinese companies from seeking other avenues of cooperation with Montenegro in the energy sector. In 2013, the Pljevlja II lignite power plant project attracted initial interest from Chinese companies: *China Machinery Engineering Corporation* (CMEC), *China National Electric Engineering Co.* (CNEEC), *China Environmental Energy Holdings Co.* (CEE Holdings), *Gezhouba Group*, and *Hubei-Powerchina*. Although the

[11] The project was part of "*The Energy Development Strategy of Montenegro by 2025*" (EDS 2025).

government set the emissions levels in line with the EU's *Industrial Emissions Directives* (IED), none of the shortlisted Chinese companies submitted offers in line with these standards.[12] Other potential investors – e.g. the Czech company *Skoda Praha* - later also withdrew. In September 2019, the government cancelled the project entirely, making Montenegro the first Western Balkan country to officially cancel a new coal project (Milev-Čavor 2019).

Both examples illustrate that Chinese attempts to engage in (energy) infrastructure development projects in the Western Balkans are *not* a linear success story. Many ambitious projects either remain in the planning stage or never get off the ground despite vibrant rhetoric. Others lack the appropriate financing arrangements, environmental impact assessment or economic viability. Chinese companies may submit bids, but also withdraw from tenders. But these examples equally highlight that project delays or their cancellation neither deters the government, nor potential Chinese companies from seeking other avenues of cooperation on a later occasion. In that respect the Sino-Montenegrin highway project is a noteworthy case in point.

The 165 km flagship project links the port of Bar on Montenegro's Adriatic coast to the border of landlocked neighboring Serbia. Anybody familiar with the mountainous terrain, viaducts and canyons of Montenegro will immediately understand what a complex undertaking it is to build a highway that requires a number of imposing bridges and deep-cut tunnels. The first phase of the project started in 2014. The contract was awarded without (!) an open tender process to a consortium including the *China Road and Bridge Corp.* (CRBC) as well as Montenegro's *Bemax* (Hopkins and Kynge 2019).

The remaining three parts are planned to be completed by CRBC on a public-private partnership (PPP, Barkin 2018). China's *Exim Bank* is providing an USD 944 million (809-million-euro) loan to finance the project's first section.[13] This represents 85 percent of the total loan, at a two percent interest rate. The repayment is structured over a 20-year duration with a six-year grace period. The government in Podgorica has provided Exim Bank with a sovereign guarantee on the loan. A closer look at the financing and construction agreements also yields the following:

- The Chinese company chosen to construct the priority section of the Bar-Boljare highway will not have to pay any taxes in Montenegro or customs duties for the import of construction materials.
- More specifically, Podgorica is exempting Chinese contractors and subcontractors working on the new highway from paying VAT, customs duties, taxes and fees for engaging foreign workers and corporate income tax.
- The Chinese will also pay three times less excise taxes on fuel imports.
- Significantly, in case of disputes over the construction and financing contracts, the competent courts will be situated in Beijing and arbitration efforts are undertaken according to Chinese law. Montenegro is the first country in the Western Balkans to include such arbitration provisions in the terms of reference for a high-profile infrastructure development project.

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[12] The Directive 2010/75/EU of the European Parliament and the Council on industrial emissions is the main EU instrument regulating pollutant emissions from industrial installations.

[13] It is important to underline that the loan repayment is denominated in USD currency. This implies the risk of currency fluctuations between USD and the euro, thus potentially making the loan more expensive (or cheaper) over time. However, the contract does not include any hedging arrangements from the Montenegrin side to account for such potential currency fluctuations.

Two elements of this Sino-Montenegrin highway project have given rise to specific concerns: For one, the lending standards Chinese companies demand from the host country in concession contracts. This includes the exemption from taxation, customs duties but also demanding sovereign guarantees for projects whose economic viability is in question. The insertion of flexible funding arrangements if and when host countries use Chinese workers and equipment is particularly contentious.

The other issue concerns the potential for debt-sustainability challenges. Other international lenders such as the *World Bank*, the *IMF* and the *European Investment Bank* (EIB) have raised red flags, i.e. that the infrastructure project puts Montenegro at risk of debt distress, thereby shrinking the government's fiscal space in the future. The label "debt-trap diplomacy"[14] has become a recurring criticism of Chinese banks' funding arrangements vis-à-vis countries who are rather inexperienced in the complexities of project financing in infrastructure lending. The highway project in Montenegro is thus a cautionary tale in its own right:

- In 2018, Montenegro's public debt (general government gross debt) reached USD 3,891 million, increasing by USD 671 million compared to 2017. The debt-to-GDP ratio in 2018 reached 72.07 percent, a 5.77 percentage point rise from 2017, when it registered at 66.3 percent of GDP (countryeconomy.com 2019).
- China's loan substantially increased Montenegro's debt-to-GDP ratio, and there are convincing reasons to be critical about the loan and the highway project. When considering that Exim Bank's loan totaled USD 944 million, then China's share of Montenegro's total public debt reached 24.26 percent in 2018. If we consider the data for 2014 - when the loan was made (Montenegro's public debt stood at USD 2,911 million) - then China's share is even higher, reaching 32.42 percent (author's calculations based on data from countryeconomy.com 2019).

This debt exposure to a single country, based on a single, multi-year infrastructure project is exceptionally high and raises questions of sustainability. However, in budgetary terms, an important caveat is in order. Since it is a multi-decade loan, including a grace period and maturities of twenty years, the debt indeed remains a repayment challenge, but its details are not insurmountable. The problems rather arise from other indicators, e.g. when the projected toll revenue does not materialize, if the PPP model is not bankable, when additional debt is necessary to complete other sections of the highway, or when currency fluctuations adversely impact on the repayment modalities.

It remains to be seen if Montenegro may require a restructuring of its debt exposure to China in the future. If the government in Podgorica were to default within the specified timeframe on the concession agreement, "the terms of its contract for the loans…give China [i.e. Exim Bank, added by J.B.] *the right to access Montenegrin land as collateral*" (Hopkins and Kynge 2019, emphasis added, J.B.). The option for a transfer of accumulated and non-repayable external debt into land rights is significant. Johannes Hahn, the outgoing EU Commissioner for European Neighborhood Policy and Enlargement Negotiations critically remarked in March 2019: "China never cares how

[14] The former United States national security adviser (April 2018-September 2019) John H. Bolton has accused China of making "strategic use of debt to hold states in Africa captive to Beijing's wishes and demands" (cited according to Brautigam 2019).

and if a country is able to pay its loans. And if they cannot pay, there is some pressure that things are transferred into their ownership" (FT 2019).

Albania: The Return of China

China's growing footprint in Southeast Europe appears as a novel initiative in various countries of the region. But it also comes with some historical baggage and economic legacies. Albania represents a country in the Western Balkans where it is more accurate to speak of a *return* of China. The history of Sino-Albanian economic cooperation during the period 1949-1978 cannot be separated from what Beijing is undertaking in Tirana today. Both countries established diplomatic relations in November 1949. In fact, Albania was the first country to recognize the People's Republic of China. Both states joined as brothers in (ideological) arms to denounce 'Soviet revisionism' after the 20th Congress of the Communist Party of the Soviet Union in 1956 (Zickel and Iwaskiw 1994). A further cornerstone of their ideological cooperation consisted in the condemnation of Tito's Yugoslavia undertaking a "separate road to socialism".[15]

China's support for the Albanian economy was crucial during the 1970s. In 1973 and 1974, Albania sent 24 percent of its exports to China, from where it received 60 percent of its total imports (in investment goods and financed through Chinese financial support). The years 1971-1975 can be considered "the golden years of bilateral economic cooperation" (Hackaj 2018). There were 132 capital investment initiatives in all economic sectors. Major investments such as *Fierza HPP*, the *Metalurgical Combine* in Elbasan, the *Ballsh Refinery* were financed with loans from Chinese banks, while the technology and the knowhow was brought in from China. When Albanian workers met with Chinese technicians to discuss a project, the manner in which they were able to overcome the linguistic hurdles of Chinese and Albanian was by speaking together in Russian!

While economic reliance on China grew, Sino-Albanian political relations gradually deteriorated from the mid-1970s onwards. Albania's leadership under Enver Hoxha disagreed with certain aspects of Chinese foreign policy making, in particularly the path breaking visit of the U.S. President Richard Nixon to China in February 1972. Hoxha also distanced himself from the Chinese "Three Worlds Theory".[16] The breakup finally arrived in 1978 when China under Deng Xiaoping terminated its special trade relations and diplomatic tête-à-tête with Albania.

After a hiatus of more than 30 years, China's return to Albania was primarily motivated by investments in the transport and energy sectors, respectively.

- In February 2014, *Jiangxi Copper*, China's biggest copper producer, acquired a 50 percent equity shareholding of *Nesko*, a Turkish company operating copper mines in Albania for USD 62.4 million. Nesko is part of Turkey's *Ekin Maden* mining and metals group which

[15] When Albania became a member of the United Nations in December 1955, one of its key activities was to articulate and support Chinese political interests. Since China only joined the UN in 1971, it could rely on its *port-parole* in Tirana.

[16] The *Three Worlds Theory* was advocated by Mao Zedong. It argued that the international relations of China are characterized by three political economy worlds: the first world consisting of "superpowers", i.e. the United States and the Soviet Union, the second world of "lesser powers" (which included China), and the third world of "exploited nations". The Three Worlds Theory served to justify the deepening of Sino-U.S. diplomatic and commercial relations following President Nixon's visit to China in 1972.

operated through an Albanian subsidiary, *Beralb*, the Munella and Lakrosh copper mines as well as the Fushe Arrez flotation plant in Albania.

- In March 2016, Canada's *Banker's Petroleum* sold its exploration and drilling rights in the Albanian oil fields of Patos-Marinze and Kucova to affiliates of China's *Geo-Jade Petroleum* for a price of 384.6 million euros.

These initial Chinese investments in the Albanian energy sector can be seen as anchor investments. They served as a catalyst for follow-up activities by Chinese companies in other sectors.

- In October 2016, *China Everbright* and *Friedmann Pacific Asset Management Ltd.* (both based in Hong Kong) acquired 100 percent of the shares in Tirana International Airport (TIA). The acquisition included the concession to operate the airport until 2027.

These recent equity investments highlight the changing nature of Sino-Albanian economic cooperation. Today, Albania exports energy materials to China, whereas in the 1970s the profile of bilateral trade was precisely the other way around. Equally, 40 years ago the Chinese state was a credit provider to the Albanian state. Today, Chinese companies, some of which operate out of Hong Kong, are equity investors in Albania, acquiring shareholdings from private foreign companies. Finally, the role reversal of Sino-Albanian cooperation is also apparent in the following observation: In the 1960s and 1970s, China sought to support an entire economy in Albania. Today, Chinese companies focus on selected sectors such as energy and transport infrastructure in order to cater to domestic requirements (copper and petroleum) or they identify transport infrastructure projects with considerable growth potential, such as the Tirana International Airport.

Bosnia-Herzegovina: China steps-in to build hydropower plants

After numerous delays, a major China-financed infrastructure project in Bosnia and Hercegovina appears to be ready for launch. In September 2019, the construction of public utility *Elektroprivreda BiH* (EPBiH) 450 MW Unit 7 at the Tuzla thermal power plant received the green light from the Council of Ministers in Sarajevo. A Bosnian consortium of civil engineering companies is carrying out the preparatory work. Once completed, the next phase of the construction project is handed over to China's *Gezhouba Group Company* and *Gunagdong Electric Power Design Institute*.

The increased volume of electricity that Unit 7 in Tuzla is expected to produce will be coal-based. The long-planned investment is 85 percent financed by a loan from China's *Export-Import Bank*, totaling 614 million euro. The government of Bosnia's Federation entity is providing a loan guarantee for the project's costs to Exim Bank. The total cost of the project is reported to reach 722 million euro, making it the single largest foreign-financed infrastructure initiative in the country. The details of this Sino-Bosnian project are significant for a number of reasons.

- European multi-lateral lenders such as the *European Investment Bank* (EIB) and the *European Bank for Reconstruction and Development* (EBRD) – who have both been active for decades in Bosnia-Hercegovina – have refused to finance the construction of new coal-fired power plants such as Unit 7 in Tuzla. Thus, the authorities in Sarajevo turned to alternatives offered by Chinese banks and construction companies.

- Bosnia-Hercegovina is part of the *European Energy Community* (EEC).[17] This membership includes adherence to rules and standards in public procurement procedures and environmental impact assessment. Sarajevo has also committed to follow EU rules on state subsidies in the energy sector. On the basis of these obligations the loan guarantee which Bosnia's Federation entity is providing to Exim Bank can constitute an infringement of state aid regulations. Put otherwise, the question asked in the corridors of Brussels and Sarajevo is the following: Is Bosnia allowed to provide such a guarantee for a controversial power plant project under current EEC regulations?

These controversies about energy policy, Chinese lending and constructing coal fired power plants as well as loan guarantees provided by federation authorities in Bosnia Hercegovina frequently overshadow another aspect of the debate. **To what degree is the public involved in the consultation and even the decision-making process?** There are examples elsewhere, but not yet in the Western Balkans, where China is being told it cannot continue with certain energy projects if it doesn't comply with environmental impact assessment requirements and an adequate consultation process with civil society. To illustrate: in June 2019, the *National Environment Tribunal* in Kenya revoked the environmental licence of the Chinese company *Power Global*, thus blocking further construction of the country's first coal-fired power station.[18] Is it a matter of time, until the Kenyan example reaches Bosnia and Hercegovina or any other Western Balkan country?

North Macedonia: China building highways in a land-locked country

As a land-locked country in the Western Balkans, North Macedonia presents specific challenges for enhanced economic activities by Chinese companies. Since maritime considerations can be excluded, terrestrial infrastructure projects are the main priority. Thus, the focus is on establishing logistical corridors in the transport sector, particularly through motorway construction and railway modernization. But before such Sino-North Macedonian ventures could proceed, some diplomatic legacies had to be overcome between both countries.

Bilateral relations between China and North Macedonia have been fraught in the past because of the so-called "Taiwan adventure" in 1999. Following its independence from the Yugoslav Federation in 1991, Skopje's engagement with Beijing is marked by visible swings during the past twenty years. On the eve of the 1998 parliamentary elections, then deputy Prime Minister and leader of the Democratic Alternative (DA) Vasil Tupurkovski promised voters that an unknown foreign partner would donate USD one billion to the North Macedonian economy.[19] The identity of the mystery donor was revealed shortly after the election during a visit by Tupurkovski to Taiwan. News reports claimed a deal had been struck whereby North Macedonia would recognize

[17] All six countries in the Western Balkans have joined the EEC. The compact is governed by legally binding directives under the *Energy Community Treaty* (ECT). The aim of this treaty is to bring the energy policies and environmental standards of the Western Balkans in line with those of the EU as a whole.

[18] The USD two billion deal was signed with *Power Global* to finance a new coal fired power plant. The planned unit is adjacent to a world heritage site of UNESCO. The project is being funded with an export credit from the *Industrial and Commercial Bank of China* (ICBC).

[19] It has never been fully clarified how much financial assistance Skopje did indeed receive from Taiwan. Some accounts (Deseret News 2001) argue that Skopje received only USD 20 million in direct investment from Taiwan and USD 150 million in loans and technical assistance.

Taiwan's independence and establish diplomatic relations in exchange for large-scale investment in Macedonian reconstruction and development programmes.

Beijing's reaction was swift and comprehensive. The Taiwan-North Macedonia alliance broke with Beijing's insistence that countries observe its "one China" principle, a diplomatically controversial principle which states there is only one China in the world and Taiwan is an integral part of its territorial sovereignty. As one of five permanent members of the United Nations Security Council, China vetoed in 1999 a U.N. plan to extend the mandate of a U.N. peacekeeping force in North Macedonia. The "Taiwan adventure" collapsed two years later. In June 2001, North Macedonia formally resumed the diplomatic recognition of China after cutting ties with Taiwan. For its part, Taiwan formally broke off ties with North Macedonia, ending all economic aid to the Balkan country and attributing the switch in allegiance to Chinese pressure on Skopje.

Today, the legacy of this controversy hardly impacts on bilateral relations. Contrary to the public positions China has steadfastly taken regarding its non-recognition of the independence of Kosovo, Beijing has kept a diplomatic distance from the decades-long name dispute between Greece and North Macedonia. While Greece is a major destination for Chinese investments, Beijing has not taken sides in the former name dispute as it continues to take sides with Serbia vis-à-vis Kosovo.

Chinese-financed highway projects across North Macedonia are the concrete landmarks of bilateral cooperation between both countries. But these projects are also examples of lessons learned in the complexities of project finance and execution between China and North Macedonia. For a land-locked country like North Macedonia such infrastructure projects are critical for enhancing domestic transport links and regional connectivity. Both projects form part of a larger programme to build the European corridor VIII, East - West throughout North Macedonia. They would provide an East-West connection that supplements the South-North corridor that was financed by the EU *European Agency for Reconstruction* (EAR) in early 2002.

The two transport projects[20] in which Chinese companies are involved since 2014 are:

- The Kicevo-Ohrid Highway project (56.7 km) was started in 2014 based on a 411-million-euro loan agreement with *Export Import Bank of China*. The construction project connects the western resort town of Ohrid to the nearby town of Kicevo, en route to the capital Skopje. *Sinohydro Corporation* from China is the lead construction firm in the highway project. But various delays resulting from re-routing, re-arranging of financing contracts, and political controversies have delayed the completion of the project.
- The Skopje-Stip highway project from Miladinovci (near Skopje) to Stip in the eastern part of North Macedonia is 47 km long and is budgeted at 177 million euro. China's *Sinohydro Corp.* is the lead construction contractor. Local firms such as *Granit* and *Beton* work as subcontractors. The highway project was officially opened in July 2019.

Both highway projects were regulated by a Special Law which permitted to fast-track the tender process. They were initially hailed as a shining example of China-led cooperation in North Macedonia. However, the Kichevo-Ohrid highway project has become the subject of major controversies involving the former government led by Prime Minister Nikola Gruevski. Judicial

[20] In 2014, the government in Skopje also purchased four diesel and two electric trains from the Chinese company *CSR Corporation*. The contract was financed by a €50 million loan secured by the *European Bank for Reconstruction and Development* (EBRD) in London.

investigations by the *Special Prosecutor's Office* (SPO) include allegations of price inflation, non-transparent tender procedures and abuse of power in arranging the contract (Vangeli 2018).

The two "Chinese highways" as they are termed in Skopje hold some sobering lessons for the state of play in Sino-North Macedonian infrastructure development cooperation. As a result of inadequate technical planning and overly optimistic projections of future highway traffic, the terms of reference of the Kichevo-Ohrid contract were revised. This led to additional financial demands by the principal Chinese contractor Sinohydro. Instead of 2018, the new deadline for the completion of the highway is now set for Summer 2021. The construction delays and legal investigations have also impacted on local sub-contractors who are engaged in the project.

Kosovo: China heeds Serbia's call

Beijing seldom addresses domestic political issues of a foreign country in public. Nor does it have an extensive track record of taking sides in the domestic politics of countries in Southeast Europe. But in the case of Kosovo Beijing has been very vocal to voice its support for Serbia and its refusal to recognize the independence of Kosovo. The Chinese ambassador to Serbia, Li Manchang stated categorically in July 2018 that "for China, Kosovo is Serbia, and so it shall remain" (Kurir 2018). For that reason, China's representative office in Pristina is the only Chinese representation in Kosovo. Kosovo itself does not currently have any diplomatic or consular representation in China.

There are nevertheless indications that China is indirectly doing business in Kosovo. Through the assistance of intermediary companies and middlemen in neighboring North Macedonia and Albania, China is said to be acquiring large amounts of scrap metal in Kosovo which is then transferred to Skopje, Tirana or the Port of Piraeus and subsequently shipped to China. The veracity of these activities could not be independently confirmed for this background paper. What can be verified is that Kosovo has a growing trade in recyclable materials. Today, it is Kosovo's number one export commodity, according to customs data (BIRN 2019).

III. What is the EU's reaction to China's growing footprint in SEE?

This section will explore key characteristics of EU engagement with China, the BRI and Beijing's growing footprint in Southeast Europe. If and how the EU should counterbalance Chinese influence in the region is a matter of debate among and between countries. It is also important to emphasize that not every investment by China nor all lending activity by one of its policy banks should be interpreted in the context of the BRI. The authorities in Beijing now also include projects that were commenced *before* the inception of the BRI in 2013. This form of retro-active labelling is misleading.

For roughly two decades, countries in the Western Balkans have sought European Union membership. During this quest for integration, the region's six countries have also interacted with other non-EU external constituents. Most prominently among these have been Russia and Turkey. But since 2013 a new rival for Brussels, Moscow, and Ankara has appeared on the region's political economy map. In fact, the label "rival" has to be qualified. Moscow, Brussels and Ankara have good reasons to see Beijing as a [potential] rival in the Western Balkans (Doehler 2019). But Podgorica, Sarajevo, Skopje, Belgrade and Tirana have no such classification in stock for Chinese investments, loans and infrastructure projects that are being carried out across the region.

China's footprint in the Western Balkans has quickly evolved in the Western Balkans (Bastian 2017). In some countries it is more visible and articulate than in others. But with the exception of Kosovo, China is in play and intends to stay in the region. In doing so, there are lessons to be learned for Chinese companies and the political authorities in Beijing. As the Budapest-Belgrade railway project controversy illustrates, China is learning the rules of engagement with EU member states. This experience includes the (belated) adherence to EU procurement standards.

This lesson learned (and applied) is also instructive for another reason. China's business with Hungary in the railway project underlines that it is not (yet) in a position to define the rules of engagement. Trying to circumvent EU standards and regulations with the assistance of the Hungarian authorities triggered an investigation by the Commission in Brussels. Awarding a no-bid contract to Chinese companies also proved counterproductive to China's determination to increase its reputational capital in Europe. It is premature to argue that divisions among countries in Europe are there for China to leverage. In fact, trying to do so can backfire *against* Beijing.

But the amount of railway diplomacy necessary for the Budapest-Belgrade project to continue illustrates that China is starting to face a much more pro-active European Commission in Brussels. This assertiveness is not only confined to the enforcement of transparent financing arrangements, adherence to EU procurement standards and open tender procedures. The Commission in Brussels is also recalibrating its strategic outlook vis-à-vis China. In its March 2019 communication, the Commission labelled China

> "*simultaneously*, in different policy areas, a *cooperation partner* with whom the EU has closely aligned objectives, a *negotiating partner* with whom the EU needs to find a balance of interests, an *economic competitor* in the pursuit of technological leadership, and a *systemic rival* promoting alternative models of governance" (European Commission 2019b, emphasis added, J.B.).

For those familiar with the diplomatic wording and rhetorical compromises necessary in Commission communications, the March 2019 EU-China strategic outlook represented a robust and, in many respects, new departure of describing the current relationship between the EU and China. The Commission explicitly argues that

> "Neither the EU nor any of its Member States can effectively achieve their aims with China without **full unity**. In cooperating with China, **all Member States**, **individually and within sub-regional cooperation frameworks**, such as the 16+1 format, have a responsibility to ensure consistency with EU law, rules and policies" (ibid, emphasis in the original).

It is precisely this need for consistency and unity of purpose vis-à-vis China that represents the biggest challenge for the EU, its member states and the accession countries in the Western Balkans. One central policy field concerns investment screening regulation. Commission President Jean-Claude Juncker first tabled the idea of EU-wide screening regulations in September 2017. On the occasion of his yearly *State of The Union* address before the European Parliament he did not explicitly identify China by name. But Mr. Juncker focused his remarks about the need for new investment screening rules on precisely those European sectors in which China had invested heavily in the preceding years.

> "Let me say once and for all: we are not naïve free traders. Europe must always defend its strategic interests. This is why today we are proposing a new EU framework for investment screening. If a foreign, state-owned, company wants to purchase a *European harbor*, part of our *energy infrastructure* or a *defense technology firm*, this should only happen in transparency, with scrutiny and debate. It is a political responsibility to know what is going on in our own backyard so that we can protect our collective security if needed" (European Commission 2017, emphasis added, J.B.).

To back up its rhetoric and strategic recalibration vis-à-vis China, the Commission in Brussels adopted new regulations that established such a framework for screening non-EU foreign direct investment. The regulation entered into force in April 2019 and will fully apply across member states eighteen months later, i.e. from November 2020 onwards. The 28 EU member states, including the 12 EU countries that are part of the 17+1 platform, will have to adapt their national legislation to reflect the Commission's investment screening regulations. While the EU regulation provides a framework, the right of each EU member state to decide whether or not to screen a particular non-EU foreign direct investment cannot be curtailed by the Commission in Brussels (Mayerbrown 2018).

For countries in the Western Balkans the debate over the need for investment screening procedures, in particular with regard to China, is non-existent. In the case of EU candidate and accession countries, neither Serbia, Albania, Montenegro, Northern Macedonia, Kosovo nor Bosnia and Herzegovina have adopted such regulatory screening procedures. It will be telling to observe to what degree the Commission in Brussels can insist on such screening mechanisms in the accession negotiations with the two countries – Serbia and Montenegro – that are most advanced in the process. Serbia has the most diverse range of cooperation with China in the region while Montenegro has the highest lending exposure (in percent of annual GDP) to China in 2018. The open question is if political authorities in Belgrade or Podgorica will push back against such screening measures when Commission negotiators address them? Alternatively, they could slow-walk their implementation because the mechanism formally does not apply to non-EU countries in the Western Balkans.

IV. The 17+1 network

With the inauguration of the 16+1 network in April 2012 in Warsaw, Poland China joined the institution-building competition in Europe. Seven years later the network expanded to 17+1 after Greece joined at the Dubrovnik summit in April 2019. The 17+1 network is termed by Beijing as a "win-win" combination for participating countries from Central, Eastern and Southeast Europe. It is integrated in the *Cooperation between China and Central and Eastern European Countries* platform. In the course of the past seven years, China solidified this institutional architecture which organizes the annual *Central and Eastern Europe – China Summit*. The headquarters of the 17+1 network are located in Beijing. The monthly working group meetings take place at the level of participating ambassadors in the Chinese Ministry of Foreign Affairs.

In practice, the 17+1 network provides the institutional setting for China to engage on a bilateral basis with countries from different regions in Europe and with a diverse set of membership affiliations. The network is a hybrid amalgamation of states from Riga, Latvia in the Baltics to Sarajevo, Bosnia-Herzegovina in the Western Balkans. 14 countries are members of NATO, 12 states are members of the EU, six of which are equally Euro area members. The 17+1 network is a top-down, governments'-driven, leader-to-leader platform that negotiates project cooperation on a transactional basis ranging from transport infrastructure over educational initiatives to industrial park construction, agriculture and people-to-people exchanges. For a five-year overview of activities and outcomes of the 17+1 network see Delphi 2017.

With the 17+1 network Beijing's has created a platform for high-profile and visible wallet diplomacy. Within less than a decade China has become a political factor and economic interlocutor in Central, Eastern and Southeast Europe. The extent to which this has happened in three critical sub-regions of Europe has been initially underestimated by Brussels, but also underrated in Moscow and Ankara. The question thus arises, if the 17+1 framework can serve as a vehicle for China to create alternative arenas vis-à-vis the EU and other non-EU external actors operating in these sub-regions? Put otherwise, do decision makers in Beijing seek political leverage in a network such as the 17+1 platform? The flagship bilateral agreements that are regularly announced during the 17+1 summits indeed have a signalling character.

The expanding 17+1 network underscores the consolidation of China's perspective on Central, Eastern and Southeast Europe. China looks at the participating countries in these three sub-regions as forming one larger region with a diverse set of membership affiliations vis-à-vis NATO, the EU, the euro area and the five candidate and accession countries in the Western Balkans. In other words, China is trying to pool resources of this larger region into the 17+1 network. Most of the working agreements are based on bilateral initiatives. But China can extract synergies from pooling 17 countries that have not cooperated under such an institutional umbrella before.

The open question is to what degree the participating countries – in particular the five non-EU members of the Western Balkans in the 17+1 network - define their approaches towards China in a regional perspective? The evidence so far emanating from 17+1 deliberations suggests that the working relationship at the yearly summits is mostly characterized by country-by-country 'speed dating' with China. It is necessary to underline that the 17+1 framework is not a harmonious cooperation arena with common interests and joint strategies. The race to claim pride of place in cooperation with China is a recurring characteristic of the summits. It is emblematic of a larger competition among participating countries to gain China's attention, attract investments and above all secure funding for country-specific infrastructure projects. Against this background, the management of expectations represents a key challenge for the authorities in Beijing. Not only is the cohesion of the network tested. Similarly, discrepancies between the rhetoric of cooperation and the substance of projects are starting to emerge among members of the 17+1 network.

The authorities in Beijing also face a certain degree of push back from the Commission in Brussels and some EU member states outside the 17+1 network. China and the 17 participating countries therefore need to reassure the Commission that the 17+1 platform creates "complementarity" with Sino-EU relations. Since 2017, the European Commission has an observer status at the 17+1 summits. This emphasis also appears necessary vis-à-vis EU member states. Germany and France have repeatedly raised concerns about the annual summits and the substance of their proceedings.

For that matter the CEEC-China meetings now provide "Guidelines" which refer to initiatives linked to parallel EU activities.[21] One such guideline argues that the 17+1 network "takes note" of the so-called *Three Seas Initiative* established in 2016. Also known as the *Baltic, Adriatic, Black Sea Initiative*, it is a forum of twelve EU member states located in Central and Eastern Europe. The Initiative aims to create a regional dialogue on a variety of policy issues affecting participating states. The 17+1 guidelines further emphasize strengthening regional cooperation. In an acknowledgement to the European Commission the participating countries in the 17+1 network declared at the Budapest summit in 2017 their willingness to "explore synergies" between the BRI and the *Trans-European Transport Networks* (TEN-T). Such synergies could be extended to the Western Balkans, e.g. by enlarging the Belgrade-Budapest railway project "through ports of Montenegro and Albania" (all quotes Budapest Guidelines 2017).

[21] Such guidelines were first adopted at the 6th Summit of China and Central and Eastern European Countries held in Budapest in November 2017. They include a commitment to the "advancement" of the *EU-China Comprehensive Strategic Partnership*, the *EU-China Agenda 2020* and the "promotion" of cooperation in the framework of the *EU-China Connectivity Platform*, the *Investment Plan for Europe* and "supporting" the conclusion of a comprehensive *Agreement on Investment between the EU and China* (Budapest Guidelines 2017).

V. How does China's engagement in Southeast Europe compare to that of other *non*-EU external actors such as Russia or Turkey?

As China expands its footprint in Southeast Europe, the investment, lending and infrastructure profile requires Beijing to further bilateral relations with host countries. This is where the 17+1 network pays dividends for Beijing's objectives and ambitions in the region. But China also has to reckon with other players and institutions whose footprint in Southeast Europe is well established since 1990. It is therefore only a matter of time until China encounters other non-EU external actors such as Russia and Turkey who have vested interests and historical legacies in the region. In particular the potential for competition between Russia and China for influence in this geostrategic region exists. Arriving at a modus operandi with these two external stakeholders must be a key objective for China's political authorities.

A stable Sino-Russian partnership is critical, particularly where separate projects and investments in similar sectors may overlap. Seen from the perspective of Beijing, any tensions between Russia and China in a common theatre of operation would represent strategic risks to its BRI ambitions. Viewed from the Kremlin's position the point of departure is of an entirely different nature. In Southeast Europe Russia is not in a position to match China's BRI-related activities. Moscow does not have the financial resources, infrastructure development projects, and visionary objectives that Beijing is bringing to the table in Southeast Europe. The new center of gravity for countries in the region cooperating with non-EU external actors now points in the direction of Beijing, neither towards Moscow nor for that matter towards Ankara.

Historically, Russia is more adept and prepared at playing the political game in the Western Balkans than China. In the course of the past two decades, Russia has managed to establish influence in the region with a minimum of investment. Views differ over how malign Moscow's influence is in the Western Balkans. But the authorities in Moscow have considerable 'spoiler capacity' which they have repeatedly tried to utilize, e.g. vis-à-vis Montenegro's accession to NATO, in the name dispute between Greece and North Macedonia, or regarding Serbia and the non-recognition of Kosovo's independence. Only in the latter case has China taken a public position to support both Serbia and Russia in insisting not to recognize the sovereignty of Kosovo.

There are manifest differences between the activities of Beijing and the Kremlin in Southeast Europe. Russia's engagement in the region comes with historical baggage, shared cultural reference points and the heritage of Orthodox religion (chiefly in Serbia). Ever since the breakup of the Yugoslav Federation, the Kremlin has considered the region of the Western Balkans as a strategic sphere of influence. Through investments in and lending to Serbia, Montenegro and Republika Srpska in Bosnia and Hercegovina, Russia has created economic leverage, in particular in the energy, tourism, media and financial sectors. Its economic footprint is not primarily reflected in absolute volumes of foreign direct investment. Part of its strategy has been to use subsidiaries of Russian companies based in the EU, in offshore destinations and the US for corporate interventions in this region. The case of the Russian oil company *Lukoil* highlights this approach most prominently (Center for the Study of Democracy, 2018).

For China, the point of departure to get involved in this part of Europe is a different matter. The manner in which China proceeds with equity investments, infrastructure projects and large-scale lending in countries as diverse as Hungary, Serbia, Montenegro or Albania suggests that it is simultaneously offering an alternative development model through the BRI and providing funding to countries, many of which have low investment grades on international capital markets.

Furthermore, the establishment of an institutionalized framework for cooperation, namely the 17+1 network underlines the long-term and strategic approach undertaken by Beijing. Moscow has nothing similar to offer in terms of institutionalized cooperation.

However, for countries in Southeast Europe it is not always a binary choice between Moscow and Beijing. There are examples in Hungary, Republika Srpska in Bosnia and Hercegovina as well as in Serbia, where political leaders are simultaneously pivoting towards Russia *and* China. Railway investments and nuclear energy provide telling examples of such a '*ménage à trois*'. The Budapest-Belgrade railway project with significant Chinese engagement was highlighted in section II. But the Hungarian government is also cooperating with Russia in a major nuclear energy project. In June 2019, Budapest agreed to build two new blocks at the Paks nuclear facility. The Russian company *Rosatom* will be constructing the two blocks. The project has drawn considerable international attention for two reasons:

- firstly, because the Kremlin-owned company Rosatom was awarded a no-bid contract, and
- secondly, because the Hungarian government agreed to a controversial financing arrangement with Russia. Moscow is providing a credit line of 10 billion euros, equivalent to 80 percent of the total financing needs for the nuclear energy project.

Similarly, China is not the only non-EU external player involved in the modernization of Serbia's railway infrastructure (see section II). Since 2013, *Russian Railways International* and the state-owned *Serbian Railways* have a cooperation agreement to carry out the reconstruction of Serbia's railway infrastructure and deliver new diesel trains. The contract is part of a state export credit line guaranteed by the Russian Federation. The project has a total financing volume of USD 941.2 million, of which USD 800 million originate from a Russian loan to Serbia. The annual interest rate is 4.1 per cent, higher than what Serbia could receive when borrowing through the London-based EBRD or the financing arm of the European Commission, the EIB. The loan arrangement granted preferential status to Russian state-owned contractors. (Center for the Study of Democracy, 2018).

The second international conference: "*Reality Check Series: Sources, Tools and Impact of External Non-EU-Engagement in Southeastern Europe. Part II: Turkey",* held in Berlin on 05-06th June 2019 underscored that Ankara's activities in the region are *inter alia* characterized by avoiding any political power competition with China. Both Turkey and China share an overlap of interests that the region requires stability in order to proceed with their respective objectives. But while it is becoming increasingly clear through the BRI what China's medium-term endgame is in the region, the same cannot be said of Turkey. Neither does it offer an alternative package of investments and loan agreements to fund extensive infrastructure projects. Nor is it formulating a new vision for Southeast Europe as China does with historical analogies of a new 'Balkan Silk Road'.

Over the course of the past decade, Turkey and China have established extensive economic and financial ties. By some accounts, Chinese investment in Turkey between 2007-2017 reached USD 18.7 billion (Juway 2017). These investments range from ports to telecoms and real estate. More specifically:

- In 2015, *Cosco Pacific* and *China Merchants Holdings* acquired a 65 percent equity stake in Turkey's *Kumport* for USD 920 million.
- In 2017, Chinese telecom *ZTE* acquired a 48 percent equity stake in Turkish telecom device company *Netas.*

- Chinese policy banks have become key lenders for President Recep Tayyip Erdoğan's numerous infrastructure projects across Turkey. In July 2018, *Industrial and Commercial Bank of China* (ICBC) provided a USD 3.6-billion loan package for the Turkish energy and transportation sector.
- Turkey's Golden Visa immigration programme targets individuals who invest 1-3 million USD in either real estate, shares in Turkish companies or government bonds, and maintain that investment for three years. The pull factor in this visa programme could further increase Turkey's appeal with real estate buyers from China.

Despite the significant volume of economic and financial cooperation, the Sino-Turkish efforts do not intersect in Southeast Europe. Put otherwise, both countries are keenly aware of not trespassing on the other's activities in the region. But this approach does not exclude undertaking infrastructure projects that are complementary to both countries' interests. To illustrate:

- In October 2019, Serbian President Aleksandar Vučić, his Turkish counterpart Recep Tayyip Erdoğan and the three members of the Bosnian tripartite presidency inaugurated in Sremska Raca in north-west Serbia the start of construction work on the highway link between Belgrade and Sarajevo. The 1.3-kilometre bridge being constructed in Sremska Raca will physically connect the two countries over the Sava river. The Serbian part of the highway is being built by a Turkish company and its 250-million-euro cost is being partially funded by a loan from Turkey's Exim Bank, with Serbia funding the rest from its state budget.
- Another area of increased Turkish involvement concerns recent pledges by President Erdoğan to increase defence cooperation with Serbia while his counterpart President Vučić expressed interest in buying Turkish weapons. Both governments have also signed a memorandum of understanding on joint police patrols in Serbia, a framework military agreement, a protocol on cooperation in science and technology, and a memorandum of understanding between their respective development agencies (Zivanovic and Firat Buyuk 2019).

However, there are also manifest and publicly aired disagreements in Sino-Turkish relations. Turkey, with a sizeable Muslim population has not been silent on the issue of the mass detention of ethnic Uighurs in China. They are a Turkic-speaking group of mostly Sunni Muslims living in the autonomous Xinjiang region of northwestern China. The territory encompasses one-sixth of China's geography. The Uighurs are the largest ethnic group in Xinjiang. Among majority-Muslim nations, only the Turkish government has publicly denounced the mass detentions and surveillance of ethnic Uighurs in Xinjiang. In February 2019, the Turkish Foreign Ministry condemned China's "reintroduction of concentration camps in the 21st century and the policy of systematic assimilation" in its western region of Xinjiang (Qin 2019). Turkey itself is home to a large community of Chinese Uighurs. In reaction to the public criticism from Ankara, China closed its Consulate General in Izmir in February 2019.

VI. Conclusions and outlook

Over the course of the past decade China has gained a strategic foothold in Southeast Europe. This was achieved through a growing network of infrastructure projects, lending by Chinese banks and rising trade volumes. But it would be misleading to stipulate that China's growing presence in Southeast Europe only appears to be of a more recent nature. For some EU member states, e.g. Croatia, Hungary, Greece or Bulgaria, China's foray is indeed of late. Still, in the interest of historical accuracy, it is more appropriate to speak of a *return* by China to other countries in the region. In either case, China is presenting itself as a partner with a long-term vision and deep financial pockets.

China's decades-long relationship with Albania under Enver Hoxha until the late 1970s and Beijing's level of cooperation with Yugoslavia prior to and after its disintegration in the early 1990s illustrate historical ties and economic legacies. The long-standing collaboration between Maoist China and Hoxha's isolationist Albania stands out as peculiar. The diplomatic relations and commercial ties between Beijing and Belgrade intensified under President Slobodan Milošević (Bastian 2018). Furthermore, its bilateral relations with North Macedonia have been fraught because of the so-called "Taiwan adventure" in 1999.

Such historical legacies and previous economic ties have provided bridges for China's return or introduction into the Western Balkans. However, today the country of choice for China is not Albania. Prime position in terms of volume of *invested capital* is held by Serbia. For Southeast Europe more generally, it is Turkey. Moreover, China's approach has changed. Through the BRI China establishes alternative infrastructure networks for its global trade routes. The BRI also enhances its ability to reshape the profile of commerce in regions, including in Southeast Europe.

Meanwhile, neither Russia nor Turkey currently have anything comparable to offer that can compete with the BRI, its auxiliary lending institutions and the complementary 17+1 network established by China in Central, Eastern, and Southeast Europe. While China's network is further expanding – Greece joined as the 17th member in April 2019 - Moscow and Ankara can only seek to garner collateral political benefits, even if they are not of their own making.

This difference in regional institution building further highlights the asymmetry in approaches undertaken by Moscow and Ankara compared to the networking activities of Beijing. While the former are primarily reactive, the latter is pro-actively engaging in establishing a network of alliances across Central, Eastern, and Southeast Europe, irrespective of the fact if the country is a member of the EU or not. Garton Ash (2019) places Russian and Chinese activities in European sub-regions in the context of Europe struggling

> "to remain a subject rather than becoming merely an object of world politics." He goes on to argue that non-EU external actors such as "*Russia and China* merrily *divide and rule* across *our continent*, using economic power to pick off weaker European states and disinformation to set nation against nation. In the 19th century, European powers engaged in what was called the scramble for Africa; *in the 21st, outside powers engage in a scramble for Europe* (emphasis added)."

China's activities in Southeast Europe are not exclusively BRI driven. Some of its investments, lending and infrastructure development activities took place before the launch of the BRI. Even if some countries stand out – particularly investments in Turkey, Greece and Serbia – China's approach comprises a regional perspective. The only exception, for political reasons, is Beijing's non-involvement in Kosovo. Furthermore, China is also learning from its engagement with countries in Southeast Europe. During the past decade, Beijing has formed a better understanding of the operational environment and political challenges it faces in the region, particularly in the Western Balkans. This body of experience translates into policy adjustments on the ground.

- Project finance is being diversified to include multi-lateral European institutions such as the EBRD or the *European Investment Bank* (EIB). In the case of the Pelješac bridge project in Croatia, Chinese construction companies are benefiting from co-financing arrangements provided by structural funding programmes of the European Union. This outreach to European funding institutions and programmes is also a reflection of Chinese policy banks becoming more restrictive in their lending policies.
- There is a greater awareness among Chinese authorities that large-scale infrastructure projects in the region need to support the local economy, thus presenting additionality to SMEs and domestic sub-contractors. The initial approach of Chinese companies to provide the financing, the manpower and construction materials for such projects is increasingly challenged by civil society representatives, media outlets and is being acknowledged as obsolete by ministries in host countries.
- The tripartite Sino-Hungarian-Serbian railway project has been a lesson learned for Chinese authorities in the complexities of European Union *Realpolitik*. This experience includes demands for increased transparency in BRI-related infrastructure projects, an open procurement process according to EU rules and regulations with competitive bidding and better risk assessment in project selection between all parties concerned.
- As Chinese financed and constructed infrastructure projects materialize across the Western Balkans, the debate over its environmental impact has grown in volume. Particularly in Bosnia and Hercegovina the construction and modernization of coal-fired thermal power plants has put China on the spot. The contradiction of policy making is evident. President Xi Jinping has strongly advocated support for the Paris Climate Accord from 2016. But simultaneously Chinese banks are financing and Chinese firms constructing coal-fired power plants in Tuzla and have completed work on another thermal power plant in Stanari, Republika Srpska.[22]
- This apparent contradiction has impacted on the reputational capital of China's BRI. In order to address the public debate about the BRI's environmental impact, the Chinese authorities launched a green investment principle for Belt and Road projects at the second Belt and Road Forum in April 2019, emphasizing that future BRI-related investments will strive to be low-carbon and climate resilient.

Seen from the perspective of countries in the region we can argue that initially their interactions with China lacked policy coherence. The formulation of a comprehensive country strategy vis-à-vis China is only gradually taking place.[23] Its definition is also the result of lessons learned in the course of the past decade when engaging with China. What we can observe is the transformation

[22] The Stanari power plant was constructed by China's *Dongfang* and financed by the *China Development Bank*. The plant officially started commercial operations in September 2016. By that time Stanari was already out of date in terms of environmental standards. Its environmental permit stipulates compliance with the older EU Large Combustion Plants (LCP) Directive, not with the newer Industrial Emissions Directive (CEE Bankwatch Network 2019).

[23] In 2017, Slovakia's government was the first country in the 17+1 network to develop an extensive "*Strategy for the Development of Economic Relations with China 2017-2020*" (Turcsanyi 2017).

of ad hoc initiatives with China towards the emergence of a set of strategic priorities, a better understanding of the legal implications of infrastructure project finance with Chinese interlocutors, the preparation of independent feasibility studies and the acknowledgement of the urgency of capacity building in administrative expertise. This is a work in progress for most countries dealing with Chinese counterparties, particularly those in the Western Balkans. In short, countries in the region are in the process of developing agency and competence vis-à-vis China.

China's engagement in the region is diversifying into sectors that were considered unlikely only six years ago. The original emphasis was on concessionary lending for infrastructure development and anchor investments that served as catalysts. Today, China's bilateral cooperation projects include an expanding role in security arrangements. In the Summer of 2019 Chinese officers were engaged in joint police patrols with their counterparts in selected cities in Croatia and Serbia. China's telecommunications company Huawei is said to be the provider of facial recognition cameras and software for three 'Smart [Safe] City' projects in Serbia (Zivanovic 2019).

Overall, based on the empirical evidence available and the institutional architecture that it is building in Southeast Europe, **we argue that in the medium to long-term it is China as a non-EU external actor, and not Turkey or Russia which has the sustainability of effort, financial means and visionary perspective to enlarge its political economy footprint in the region**. These three factors are intertwined with a time perspective in which China defines and implements policy in terms of decades, not four-year electoral cycles of Western democracies. The competition Beijing faces today and in the coming years as regards Southeast Europe will not primarily originate in Moscow or from Ankara. It will either come from Brussels or inside China as concerns policy direction, funding volumes and project priorities. It must therefore be in the utmost interest of policy makers in Brussels, Berlin and Paris that the spreading of EU accession fatigue among societies in the Western Balkans does not create further openings for non-EU external actors such as China.

What makes China's activities in Southeast Europe such a challenge for European policy makers is the observation that through the BRI countries in the region are putting themselves in a position to implement large-scale infrastructure projects *without* the need for EU [financial] assistance. Initially, the EU did too little to publicly challenge China's deepening engagement in Southeast Europe. With the official launch of the BRI in 2013, China signaled its intention to expand investments and trade. As more countries from Southeast Europe signed up to the BRI, their political leadership saw an unprecedented opening: the dire need for infrastructure upgrades could be achieved with a policy with Chinese characteristics.

Government representatives from Tirana over Sarajevo to Belgrade and Podgorica continue to emphasize that their first-choice preference for doing business remains with the EU. But what happens when this rhetoric starts losing evidence on the ground? Is China prepared to present itself as a first-choice alternative for policy makers in the Western Balkans? Can they manage the inherent political and operational risks? EU officials are right to be concerned about the challenges these questions raise. China's willingness to build roads, railroads and ports in the Western Balkans is proving difficult to resist. In the years to come the debate over these challenges will be daunting. Simultaneously, China will continue to fascinate and attract policy makers in the region. China is not looking at short-term, immediate results. The government in Beijing is focused on where China is going to be in the next 20 to 30 years. In Southeast Europe, the EU, Russia and Turkey are facing a non-EU-external actor that is positioning itself to become an ally of choice for countries in the region.

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