

CENTRAL EUROPE WATCH

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CHINA'S NEW BALKAN STRATEGY

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Communist China did not assume a direct role in the volatile Balkan region until the late 1970s. Despite robust cooperation with Albania, mainly built upon a shared opposition to Soviet claims of world communist leadership, it was not until the summer of 1978 that Beijing articulated a coherent policy to deal with Southeastern Europe.

For a post-Mao leadership, the Balkan region had then become an important element in a broad diplomatic offensive meant to secure a foothold in the Soviet Union's sphere of influence, open up to the Third World, and forge valuable relationships with nations which could help modernize the Middle Kingdom. In effect, China severed ties with Enver Hoxha's Albania to develop tighter economic, political, and personal bonds with Josip Broz Tito's Yugoslavia and Nicolae Ceaușescu's Romania.

However, the fall of the Iron Curtain and the bloody disintegration of Yugoslavia prevented China from sustaining strong links with Southeastern Europe. As the Balkan region is returning to stability, the time has come for Beijing to invent a new strategy and spread its influence through increased trade, clean energy investments, and embryonic political alliances.

Part I: Resurrecting the Silk Road

Averaging a staggering 10 percent for the past decade, the rapid growth of the Chinese economy has been a powerful driver for the expansion of Eurasian trade. During the same period of time, bilateral exchanges between Europe and China almost quadrupled, jumping to EUR 395 billion in 2010 from EUR 101 billion in 2000, to form the second-largest economic relationship in the world. To assert its economic ascendancy on Europe, Beijing has focused on tapping the Balkan Peninsula's unexploited business potential by making strategic investments in Greece, and drafting long-term plans for a modern Silk Road across the Eurasian landmass.

A Blooming Chinatown

China's trade relations with Southeastern Europe initially focused on developing exchanges with the region's largest markets, coincidentally corresponding to the countries on track to joining the European Union (Romania, Bulgaria, and Croatia). In 2010 bilateral trade with Romania amounted to EUR 2.6 billion, while business with Zagreb and Sofia was valued at EUR 1.1 billion and EUR 630.5 million, respectively. However, when compared to similar-sized EU markets, the data shows these figures have the potential to increase tenfold: Austria – with a population similar to Bulgaria's – registered a EUR 8.2 billion-worth two-way trade with China last year.

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Aside from Albania and the small Montenegrin market, where China has become the second trade partner after the EU, the Western Balkan region also retains untapped business potential. Indeed, bilateral exchanges with Serbia amounted to only EUR 325 million in 2010, despite a 20 percent year-to-year increase, ranking China 8th among Belgrade's associates. Similarly, with commercial exchanges at EUR 107 million, Beijing is Macedonia's 7th largest business partner, while it accounted for only 0.6 percent of Bosnia-Herzegovina's international trade with EUR 43 million last year.

Yet, Southeast European markets have great potential for affordable Chinese products. Beijing has therefore aimed at boosting exports to the region by setting up Chinese trade centers close to major roadways and densely populated areas. The largest Chinatown in the Balkan region opened on 19 July 2011 in Afumati, a small city on the outskirts of Bucharest, where some 1240 stores covering 40 hectares now sell Chinese products straight to the Romanian capital's two million inhabitants. Elsewhere, the "China Trade Center Zmaj" was inaugurated near Belgrade in June 2010, imitated by Zagreb's Chinatown Center two months later. In Bulgaria, negotiations are currently being carried out to launch a similar business zone for Chinese imports in Bozhurishte, ten miles north of the capital Sofia.

Chinese enterprises not only compete on local markets, they also build manufacturing bases in the region. In November 2009, state-owned auto-giant Dongfeng struck an agreement with Serbian truck maker Fabrika Automobila Priboj (FAP) to assemble vehicles in Serbia. Chinese car maker Great Wall Motor Co and Bulgarian company Litex Motors also started rolling out low-cost cars in February 2011. As such, the region serves as a "training ground" for Chinese companies to gain the industrial maturity and technological sophistication necessary to successfully enter Western markets. Southeastern Europe also allows China to circumvent the EU's anti-dumping regulations and export products directly to a market of some 800 million people thanks to free-trade agreements with the EU, Russia, and Turkey.

Beijing is also eager to enhance Balkan imports. China has been placing chips on regional mineral exploitation to help sustain the high growth rate of its economy. China's largest metals trader China Minmetals Corporation signed a USD 800 million deal with Aurubis Bulgaria, a local subsidiary of Europe's leading copper smelter, in October 2009. Six months later, in April 2010, Sichuan Jiannan-

chun International Group partnered with Turkey's Kürüm Energy, Resources and Metallurgy to form Illyria Mineral Industry and develop Albanian ferro-chrome exports to China. Endowed with large deposits of iron and copper ore, Bosnia-Herzegovina and Kosova could soon welcome similar projects. Local machinery companies are also in high demand on the ever-growing Chinese market. Regional industrial leaders such as Serbia's mechanical and engineering company Goša FOM, Romania's tool manufacturer World Machinery Works, or Bulgaria's forklift producers Balkancar Record Company and Di-Ven all have the potential to assert their position in China, where they can successfully compete with pricier Western products.



Greece: the European Node

To increase commercial exchanges with Southeastern Europe, China has made considerable investments in Greece. Since the onset of the country's debt crisis, Beijing has been playing a proactive role by supporting the purchase of Greek bonds, announcing plans to double its annual trade with Athens to USD 8 billion by 2015, and setting-up a special Greek-Chinese shipping development fund of USD 5 billion.

More strategically, at the height of the financial crisis, in November 2008, Chinese President Hu Jintao signed a EUR 3.4 billion agreement to allow the state-owned China Ocean Shipping Company (COSCO) to upgrade and run part of the country's chief port in Piraeus. The deal's entry into force on 1 October 2009 also allowed COSCO to enhance the port's capacity by building a third pier. The pending construction of a logistics hub in nearby

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Attica should help attain the goal of tripling operations up to 3.7 million containers by 2015. Ahead of these projects, Beijing has already decided to gradually stop using the ports of Naples and Istanbul to redirect maritime traffic toward Greece.

Furthermore, COSCO is bidding to operate the port of Thessaloniki, linked by rail to the rest of the Balkan Peninsula into Central Europe. The Chinese government is also vying to buy shares of the struggling state-owned Hellenic Railways Organization (OSE), scheduled to go up for privatization in the years to come as part of the massive Greek deficit-reduction plan. Such a move would allow the rapid delivery of Chinese products transiting through Greece.

This planned Chinese takeover of maritime and rail assets intends to transform Greece into a Southern rival for Northern Europe's Rotterdam. Indeed, the country's strategic position makes it easier for container ships transporting Chinese goods to travel from East Asia to Europe via the Suez Canal. It also provides an ideal base to reach emerging markets in the Mediterranean Basin and the Black Sea region. In other words, Beijing sees Greece as a modern gateway linking Chinese factories with consumers across Europe, the Middle East, and North Africa.



(Re)connecting Markets

Prior to the 1990s, most freight travelling from the Eastern Mediterranean to the Western European market was transported through Yugoslav territory. The territorial fracturing of the Balkan Peninsula coupled with damaged transportation infrastructure had an immediate consequence for rerouting of an estimated 75 percent of cargo through short sea shipping, the remaining 25 percent be-

ing moved by road or rail through the Eastern Balkans onto Central Europe or the former Soviet Union.

Planned for the end of 2013, the completion of Pan-European Corridor X will reconnect Western Europe to Turkey by knitting together the former Yugoslav republics along the old Brotherhood and Unity Highway. However, the slow development of the 10th pan-European rail corridor will hamper commercial traffic from relying on the backbone of the Balkans. Thus, Chinese entrepreneurs and the China Development Bank (CDB) recently expressed great interest in financing and building the EUR 4.5 billion railway passing through Serbia and the Belgrade-South Adriatic highway. To convince Serbian authorities, China could deploy advantageous financing similar to the conditions offered for the construction of the EUR 170 million Zemun-Borča Bridge. Belgrade's so-called "Serbian-Chinese Friendship Bridge", set to link both banks of the Danube in 2014, will indeed be built by the China Road and Bridge Corporation (CRBC), financed at 85 percent by a low-interest loan from the Export-Import Bank of China.

By investing in the region's infrastructure projects, Beijing wants to accelerate the creation of a network of ports, logistics centers, and railways to distribute Chinese products and hasten the speed of East-West trade. Indeed, the great commercial integration of Europe and China reveals the incredible potential of a transcontinental trade route linking both markets. Beijing is therefore attempting to resurrect the ancient Silk Road to improve transport and trade through the Eurasian landmass. This new route, complementing a "Silk Track" railway, would run from Western China through Central Asia, Iran, Turkey, and across the Bosphorus onto the Balkan Peninsula to boost connections with Europe and the Middle East. Beijing's grand plan would offer a major shortcut to the traditional sea trade routes from the Chinese ports of Shanghai and Guangzhou, in effect cutting travel time to European markets from an average 36 days by container ship to only a dozen days by freight train, while providing a cheaper (USD 111 against USD 167 per ton) and safer alternative to the piracy-ridden Gulf of Aden.

In fact, a Northern rail route between Europe and China has already been launched. On 30 June 2011, a cargo train packed with Chinese high-tech products left Chongqing for a 13-day trip to Duisburg, Germany by way of Kazakhstan, Russia, Belarus, and Poland. Yet, long-term plans for a Southern route through South-Central Asia will ultimately allow faster shipments by avoiding bogie exchanges and transloading at break-of-gauges

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between the former Soviet rail networks and the standard system used in China, the Middle East, and Europe. Nonetheless, the completion of the modern Silk Road will also require addressing many challenges, such as a globally underdeveloped transportation infrastructure, security concerns across the Middle East, and taxation and customs barriers.

Part II: Investing in a Clean Energy Future

Miraculously unscathed by the global financial crisis, China has taken advantage of its deep pockets to outpace cash-constrained Western rivals in a new strategic niche: clean energy. For the past few years, Chinese companies have benefitted from Beijing's institutional support, the rising price of oil, and greater international awareness over climate change to become a leader in green investments. A potentially lucrative market, South-eastern Europe has garnered considerable attention from the Far East.

European Requirements

The 1990s fragmentation of the Balkan energy market caused sporadic disruptions of supply to EU members (such as Greece, Austria, or Italy) and jeopardized key connections with Caspian, Central Asian, and Middle Eastern oil and gas reserves. As Brussels began to reorganize its internal energy market, the EU took a more active stance in promoting stability and sustainable development in Southeast Europe. Negotiations within the so-called Athens Process eventually led on 1 July 2006 to the establishment of the European Energy Community (EEC), by which the European Union extended its energy market to the Balkan Peninsula.

In order to address Europe's three key objectives of ensuring affordable access to energy, sustainable development, and security-of-supply, Southeastern European countries committed themselves, through the EEC, to build an adequate regulatory framework, liberalize their energy markets, and implement a set of energy security and efficiency in line with relevant EU legislation. In other words, the creation of the EEC amounted to a *de facto* partial integration of Southeastern Europe into the EU single market. Accordingly, the Balkan states pledged to achieve EU standards in power production by 2015.

As the Western Balkan region progresses on the path to European integration, consistent efforts will be necessary to abide by the bloc's *acquis* on energy. For instance,

Croatia's negotiation talks have shown that future EU members will need to address additional challenges to ensure the protection of the environment, a sufficient use of renewable sources of power, and greater energy efficiency. To meet the bloc's stringent energy requirements, Zagreb has therefore pledged to meet at least 20 percent of its energy needs, in production and consumption, from renewable resources by 2020.

Moreover, the final adoption in June 2009 of the "EU climate and energy package" introduced extra rules and regulations ahead of the full European integration of the Western Balkans. The European plan on climate change will require a 20 percent cut in emissions of greenhouse gases compared with 1990 levels, a 20 percent increase in the share of renewable in the energy mix, and a 20 percent cut in energy consumption by 2020.

A Vital Need for Investment

The Southeast European energy network consists of infrastructure built for the most part in the 1960s and 1970s using standard Eastern bloc technology and testing amongst the least energy efficient in Europe. Besides, a large part of the Western Balkan infrastructure was damaged during the 1990s' conflicts, thus making even more urgent the need for a widespread power plant rehabilitation program. Extreme peaks of use during harsh winter or scorching summer days can lead to blackouts or force energy rationing. The general lack of reliable electricity supply remains to be a serious obstacle to economic development and foreign investment. Moreover, regional energy markets rely heavily on imported hydrocarbons: in 2005, import dependency ranged from 32 percent for Bosnia-Herzegovina and Serbia to 58 percent for Croatia. To address these challenges and enhance the Peninsula's energy security, Southeastern Europe has been engaged in a lengthy rebuilding and reforming process. As part of the European integration process, it has become necessary to explore the region's untapped potential of domestic renewable energy resources.

Indeed, countries such as Albania, Bosnia-Herzegovina, Croatia, and Montenegro retain wide hydropower capacities. As an example, Tirana only uses 35 percent of its estimated hydro potential even though 90 percent of its energy needs are produced by dams, an enviable situation which could make the Balkan state the first green energy nation by the end of the decade. In eastern Macedonia, it is estimated that wind could operate windmills up to 170 days a year to theoretically secure seven percent

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of the countries' annual electricity needs. Likewise, Serbia's Vojvodina plain and Croatia's 400 mile-long Adriatic Coast have considerable wind energy potential.

The global financial downturn has made it very difficult for cash-strapped Balkan countries to free funds to invest in green energy. The economic crisis has also meant that European electricity companies exercise more restraint when considering new investments in Southeastern Europe. Italy's Enel and Germany's E.ON, and the Czech CEZ have for example called off an agreement to build a 400 MW gas-fired power plant in Romania due to unforeseen costs.



China Rolls In

With major Western utility companies unwilling to make risky investments, the Balkan energy sector is giving China the chance to compete on a global scale. Over the past few years, Chinese investors have increasingly targeted new energy projects in the region. In Romania, the China National Electric Equipment Corporation has already laid out a EUR 1 billion plan to build a 500 MW thermal power plant, and the Chinese Nuclear Power Engineering is expected to build two new nuclear reactors at Cernavodă. Beijing will also take over the construction of the EUR 1.3 billion, 1000 MW Tarnița-Lăpușești hydroelectric power station project. In neighboring Bulgaria, China's National Nuclear Corporation has expressed interest in building a new 1000 MW nuclear unit at the Kozloduy nuclear power plant (NPP). Chinese companies are also likely to take advantage of the stalled talks be-

tween Sofia and Moscow to realize Bulgaria's project for a second NPP in Belene. Besides, China's Exim Bank has agreed to a EUR 1 billion soft-loan to Elektroprivreda Srbije to upgrade Serbia's electricity network and build a new thermal power plant in Kostolac.

Not only willing to take bigger risks than their European rivals, Chinese companies are also able to finance the projects on very favorable terms. For instance, the China Development Bank (CDB) is currently funding the construction of a 300 MW coal-fired plant in Stanari, Bosnia-Herzegovina. The EUR 500 million project, carried out by China Dongfang Electric Corporation, will cost only half the price of competing proposals made by France's Alstom or a Canadian-Polish consortium of SNC-Lavalin and Rafako.

A worldwide leader in clean energy, with global investments valued at USD 34.6 billion in 2009, China is rolling out its green expertise in the Balkans. Chinese companies Polar Photovoltaics and Wiscom Systems plan to build a 2 MW solar power plant in Ihtiman, western Bulgaria. In April 2011, the Public Power Corporation of Greece signed an agreement with Sinovel Wind, China's top wind turbine maker, to develop a 200-300 MW wind farm and an offshore wind park. The same month, China International Water and Electric Corporation signed a Memorandum of Understanding with the government of Macedonia to build 12 hydropower plants along the Vardar River, from Kosova to the Greek border. The EUR 1.5 billion, 15-year superproject will be financed up to 85 percent by a loan from the China Development Bank.

Although by no means limited to Southeastern Europe, China's growing involvement in clean energy projects follows a long-term strategy. Indeed, by investing in potentially lucrative Balkan markets which remain to be fully liberalized, Beijing is building assets and buying future stock in a region with direct links to the EU. Furthermore, Beijing is increasingly looking to sell power equipment abroad as a way to compensate for the long-term fall of prices in energy hardware due to increased scale, improved efficiency, and over-capacity. As a result, China has already managed to leapfrog past its Western competitors and emerge as the world's largest maker of wind turbines and solar panels, while pushing as hard to build clean-coal power plants and nuclear reactors. Without strong governmental policies supporting future technologies, both in the U.S. and in Europe, the West may someday swap its dependence on oil from the Middle East for a reliance on energy technology manufactured in China.

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Part III: A New Player in Regional Politics

Because money and influence are closely intertwined, Beijing's sizeable investments in Southeastern Europe are as much about financial returns as they are about leverage. Even though the political side of China's Balkan policy primarily relies on Serbia, Beijing's economic power has opened more doors throughout the region. Investments by Chinese state-owned companies on the periphery of the EU have not only given China an indirect say in European affairs; they have also signaled to the U.S. and the West that Beijing is ready to advance its own agenda in the region.



The Serbian Friend

A staunch supporter of Yugoslavia since the late 1970s, China maintained strong links with the Serbian leadership even as Belgrade faced international isolation over its role in the Balkan wars. As Serbia re-integrated in the international community following the downfall of Milošević, Belgrade initiated a substantial foreign policy shift by formulating the “four pillars of diplomacy” doctrine and placing Beijing on the same level as Washington, Brussels, and Moscow. In August 2009, Serbian President Boris Tadić's third visit to China culminated with the conclusion of a strategic partnership, through which both countries committed to defend each other's basic national goals. Thus, the bilateral agreement tied Belgrade and Beijing in a policy of mutual respect for territorial integrity and sovereignty, in effect cementing China's opposition to Kosova's independence.

For the past decade, China has been consistent in its Kosova policy: Beijing was a strong opponent of the 1999

NATO bombing campaign against Serbia, vehemently denouncing the Western intervention as an act of aggression against international law. Since 2008, the Chinese leadership has regularly spoken out against Kosova's declaration of independence. On 7 December 2009 China submitted a written advisory opinion to the International Court of Justice defending territorial integrity as a cornerstone of the international legal order and giving to states the right to prevent unilateral secessions. More recently, Beijing also backed Serbia's call for a UN investigation into alleged organ trafficking committed during and after the Kosova War. China's support of Serbia on the Kosova issue mainly stems from the concern that its own minority groups might follow Prishtina's lead toward independence. With 56 recognized minorities, secessionist movements in Tibet and Xinjiang, and two special administrative regions (Hong-Kong, Macao), Beijing fears that the Western push for the international recognition of Kosova might lead to greater demands for autonomy within China and undermine the One-China policy.

In return for its political backing, Beijing has managed to gain significant leverage in Belgrade. As an example, the Serbian government adopted a state policy not to join any initiatives criticizing China in international forums. Effectively, Serbia was among the 19 countries to boycott the ceremony awarding the 2010 Nobel Peace Prize to Liu Xiaobo for his struggle for fundamental human rights in China. Despite criticism from the European Commission, which urged Serbia to fully share the EU's core values, Serbian Foreign Minister Vuk Jeremić explained that Belgrade had decided to take into account “[its] relations with key political players in the world” and reflected the fact that China “[had] offered unconditional support in [Serbia's] difficult moments”. Moreover, since 2008, Serbia has refused to join EU initiatives criticizing the state of human rights among Beijing's international protégés (e.g.: Iran, Sudan, Zimbabwe, Myanmar, and North Korea).

Arms Wide Open

Over the past decade, the People's Liberation Army (PLA) has also stepped up military cooperation throughout the region. Eager to multiply high-level exchanges with European armed forces, the PLA deepened ties with Albania and Croatia in 2005, Serbia and Bosnia-Herzegovina in 2008, Montenegro and Macedonia in 2010, and pledged to expand collaboration with Bulgaria, Romania, and Greece in 2011. In August 2010, Serbian Defense Minister Dragan Šutanovac announced plans for further military cooperation by giving special considera-

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tion to defense industries, with a view to the joint production of military equipment. Collaboration between the Chinese and the Serbian defense industries could open up the possibility of sales to third countries in Africa and the Middle East (e.g.: Libya, Iraq), which are traditionally top customers of Belgrade's arms production. Even though the PLA's increased ties with Southeastern European armies are not likely to endanger the EU or NATO's security, they have the potential to undermine EU foreign policy goals by encouraging weapons' sales to troubled parts of the world. The proposed co-production of arms also challenges the EU's embargo against China, imposed in response to the suppression of the 1989 Tiananmen Square protests, by opening alternative routes for Beijing to seek and produce advanced weaponry.

Besides, since the onset of the global economic crisis, China's increased bilateral ties with Southeastern European countries have served as a means to advance its goal in the European Union. For instance, the question of China's market economy status has recently found a new impetus in Europe. During his recent 4-day visit to China, Romanian Prime Minister Emil Boc underlined that Bucharest was ready to defend Beijing's position vis-à-vis Brussels in return for stronger political and economic ties. Likewise, Athens pledged in October 2010 to promote the development of the China-EU comprehensive strategic partnership and vowed to lead discussion within the EU over the recognition of Beijing's full market economy status, in exchange for enhanced economic cooperation.

Thus, through these new partnerships, Beijing can directly influence state policies in Southeastern Europe. Although China's ties remain mainly limited to Serbia and Greece, a regionwide movement appealing for deeper economic and political cooperation could increase Chinese leverage in the Balkan Peninsula and create a relation of dependency with countries expected to join the EU within the next 10 to 15 years. Down the road, Beijing could manage to create a favorable environment within the EU, with possible consequences for European policy-making.

Policy recommendations

- Balkan countries aspiring to join the EU should be fully committed to defend core European values and EU foreign policy goals. Failure to do so will be a stumbling block on their path to EU integration.
- The EU should redouble efforts to develop renewable energies throughout Europe. The short-term goal of enhancing Europe's energy security and the medium-term goal of sustainability should not be pursued at the expense of long-term dependence on Chinese green expertise.
- The EU should keep on funding major infrastructure projects to maintain its political and economic influence throughout Southeastern Europe. The EU should also continue pressing Balkan countries to improve their business environment in order to attract Western investors.
- Beyond trade and two-way investments, Beijing and Brussels should develop multi-level mechanisms for bilateral consultation and coordination to minimize the turmoil provoked by competition and conflicting interests in the China-EU relationship.



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