



Corrosive Capital in the Western Balkans: An Analysis of Four High Impact Chinese Investments

In this paper, Damir Marusic, Senior Fellow at the Atlantic Council, analyzes the impacts of corrosive capital on corruption in the Western Balkans. He presents and examines the key findings of four recently published policy reports by Center for International Private Enterprise (CIPE) local partners in North Macedonia, Serbia, Bosnia and Herzegovina, and Montenegro. Each report investigates the negative economic and environmental consequences associated with Chinese investment throughout the region. To close, Marusic provides a series of recommendations for the European Union (EU) and national governments to prevent corrosive impacts from exacerbating the region's governance gaps and struggles with corruption.

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Ivan Krastev once famously described the Western Balkans as the “[soft underbelly of Europe](#) [↗](#).” He was writing in the year after Russia annexed Crimea and was warning European leaders worried about destabilization coming from the Kremlin to turn their gaze southward. “Logic dictates that if Russia wants to increase the pressure on Europe, it should try beyond the territory of the former Soviet Union,” he wrote.

Since then, Krastev’s observation has become something like received wisdom. Balkan experts, myself included, have pointed to the region as a lingering vulnerability for the West. The historical analogies write themselves: World War I was kicked off by an assassination in Sarajevo, but well before that, the “Eastern Question” kept policymakers in European capitals up at night. Richard Holbrooke’s firm advocacy for intervention in Bosnia was informed as much by a desire to uphold human rights as

it was by a fear that if the war’s logic was not checked, ethnic partition would come soon enough to Kosovo. This could, in turn, pull Albania, Greece, and Turkey into a fight that would make the first Balkan Wars seem like mere scuffles.

But as the region grew uneasily peaceful in the early 2000s, that urgency faded. With the EU ushering in the euro, faith in the so-called liberal world order was at its height. For the countries of the Western Balkans, like the rest of the world, there was no alternative to becoming full-fledged members of this emergent, peaceful, trade-based system. Proponents of globalization described it as “a rising tide lifting all boats,” albeit at an uneven pace. The problems that remained to be solved were real enough, but they were ultimately technocratic in nature — apolitical — and would be worked out over time. Corruption was one such problem.

While it might be too cute to say that corruption is as old as the world's oldest profession, the issues we commonly group under that umbrella term have been present since state-level societies first emerged from their clan- and tribe-based precursors. The idea that a state is not merely the property of its ruler, but rather a kind of public trust, only started to coalesce in the West in the seventeenth and eighteenth centuries. It was only with the advent of the American and French revolutions that this paradigm shift began to assert itself.

Despite these changes, corruption has stayed with us. Students of democratic development are quick to point out that the kind of clientelism and patronage roundly denounced by transparency NGOs these days was the norm in emerging republics all across the West, especially so in the United States. Even in so-called advanced, consolidated democracies, clientelism and patronage networks persist as an organizing principle to this day, one that is only partly subsumed by increasingly democratically accountable institutions. As Francis Fukuyama noted in his seminal book *Political Order and Political Decay*, "The big historical mystery that has to be solved is thus not why patronage exists, but rather why in modern political systems it came to be outlawed and replaced by impersonal organization."

While naked systems of patronage may have been mostly outlawed in the modern West, they continue to be tolerated in the rest of the world to various degrees by both locals and the international development community. For most of the 20th century, concerns about corruption were secondary to the competition for the hearts and minds against the deep-pocketed Soviets in what was then termed the "second" and "third" world. But the lack of concern outlasted the Cold War. Arguably, it wasn't until World Bank President James Wolfensohn made his ["cancer of corruption" speech in 1996](#) that the Western NGO world started grappling with what would prove to be a very thorny issue.

The intractability of corruption has long been prominently on display in the Western Balkans. In 2003, analyst David Kanin [described](#) the region as always existing "at the margins of succeeding global economies." Too sparsely populated and fractious to emerge as coherent states, the region's peoples have long survived through being ruled by so-called Big Men, local notables who intermediate between imperial powers and local economies. Since the 19th century, Kanin argued, these men "gilded themselves with Westernized political party labels, but modernization mainly meant they were able to use

Westernizing structures to broaden and deepen traditional patronage networks.” This pattern, he argued, persisted through the communist era and emerged largely intact after the Cold War ended. Instead of the Ottoman or Austro-Hungarian Empires trying to govern and modernize these lands, an army of Western technocrats was trying to do the same. Ingrained governance patterns die hard.

Understanding this dynamic is not to make excuses for corruption, but rather to add necessary context. This social dynamic is what revisionist powers are exploiting as they challenge the West in the Western Balkans. In 2015, the focus was on the Kremlin, whose strategy was to create messes and be invited to fix them. Today, the more insidious challenge is coming from China, which is using its vast capital reserves and local indifference to transparency to buy influence throughout the region. To be sure, part of the dynamic reflects a strategic imbalance, with small emerging economies facing a large authoritarian state capital model that throws money around in a way that flouts market logic. But the result is a perpetuation of these long-standing trends, and a brake on reform efforts.

The included four reports lay out different facets of the same story unfolding across several of the successor states of Yugoslavia—Montenegro, North Macedonia,

Serbia, and Bosnia and Herzegovina.

Using illustrative case studies, the reports together paint a picture of the current state of Chinese penetration in the region. Many of these cases are shaping the news today. Montenegro [recently asked](#) for a bailout from the EU to help pay off its Chinese loan financing an economically questionable highway project (and has been rebuffed). And protests against widespread pollution, labor abuses, and general lack of accountability for Chinese firms prospecting for copper and gold deposits in rural Serbia have [rocked](#) Belgrade.

The current term of art is that China is deploying “corrosive capital” into these societies, and there is much to recommend this expression. The lack of transparency attendant to these murky deals does real damage to the eventual emergence of accountability institutions. Nevertheless, one should not fool oneself into thinking that “corrosive capital” is itself the root problem. It isn’t. Chinese efforts are falling on fertile ground, and while reports such as these ably map out the contours of the damage they are doing, ending these practices only gets us back to square one. The work of getting the Western Balkans to surer footing is daunting, but ultimately unavoidable if these countries hope to improve their governance and ensure a better future for their populations.



Montenegro

Apart from some investments in

Montenegro's energy sector (including in renewables), China's major foray in the Adriatic country's economy has been its investment in the Bar-Boljare highway, a 170-kilometer route through rugged terrain that would connect the port city of Bar with the Serbian border. A critical infrastructure project for modernizing Montenegro, the highway had been plagued by setbacks throughout the 2000s, until finally in 2014 the Chinese swooped in.

The report by the Center for Democratic Transition (CDT) located in Podgorica, suggests that local elites have benefited handsomely from the deal. Though several feasibility studies were done ahead of breaking ground, they remain hidden from the public. Some of these assessments have been leaked to journalists, who have reported that the project would never be profitable.

Nevertheless, it appears that between 2008 and 2010, Montenegro's government tried to get the deal done with more transparent partners. A Croatian firm responsible for building and maintaining Croatia's new



Komarnica bridge on the highway from Bar to Boljare in Montenegro.

Photo Credit: Government of Montenegro

highways won the concession first, but the deal fell through when financing did not materialize. The second-placed Greek-Israeli consortium also failed to come up with financing ahead of a set deadline.

By 2011, Montenegro's government and the Government of the People's Republic of China had signed an agreement on the promotion of cooperation for infrastructure construction. The deal was officially ratified two years later and amended to broaden the scope of allowable financing vehicles — a move that allowed the government to skirt its public procurement procedures due to a loophole that made exemptions to provisions found in international treaties. As a result, the details of the final deal with China remain completely opaque apart from what dribs and drabs the government has disclosed voluntarily.

Since breaking ground in 2015, the project has bogged down. Phase 1, the most costly and challenging part of the project, was slated to be completed in May 2019 but was pushed back to September 2020, even as cost overruns multiplied. The force majeure of COVID-19 appears to have pushed completion well into 2021. Meanwhile, clauses in the original contract guaranteeing that 30 percent of the work be subcontracted out to local firms seem to have guaranteed a handsome windfall to politically connected players — to the tune of some €445.31 million.

Many of the planning documents connected to the project have been classified, thus stonewalling transparency NGOs. Beyond local corruption, there are profound worries about environmental degradation and the long-term fiscal impact completing the project will have on Montenegro for decades to come. The current investment, which has yielded a real-life "road to nowhere," has already ballooned the debt to almost 90 percent of GDP. Recovery after COVID ought to stabilize the situation some, but only fiscal discipline can get the country back to more sustainable debt levels. (As noted above, attempts to get a bailout from the EU have not panned out.)

It seemed inconceivable that Montenegro's government could countenance the abandonment of such a high-profile project through most of last year. However, late in 2020, an unprecedentedly hard-fought election sent the once-dominant Democratic Party of Socialists (DPS) of Big Man Milo Djukanovic into opposition. It's not yet clear which way the fractious and fragile new coalition will lean on Bar-Boljare, and on Chinese investment. Given that part of the coalition is pro-Serbian, it's possible that finishing the highway project will remain a high priority, even as malfeasance by the outgoing government is brought to light.



North Macedonia

A very similar dynamic to that in Montenegro has manifested in North Macedonia. At issue, there is the development of Corridor VIII, identified at the second Pan-European transport Conference in Crete in 1994, as a vital infrastructure project for developing the region. Set to connect the Adriatic to the Black Sea, the project was to build a set of highways connecting Durrës in Albania to Burgas and Varna in Bulgaria, passing through Tirana, Skopje, and Sofia in between.

As the report by Institute for Democracy “Societas Civilis” – Skopje (IDSCS) notes, just like in Montenegro, initial feasibility seems to have been an issue. Though a 2007 study by a French firm found the whole of the

Corridor VIII project viable, North Macedonia had trouble lining up partners through a more transparent procurement process for its parts of the project. And indeed, by the time willing Chinese partners materialized (in the form of the construction giant Sinohydro and the Chinese EXIM bank), the Miladinovci-Shtip highway was added to the Kichevo-Ohrid leg, something that was not included in the 2007 assessment. This action made the economic feasibility of the whole project even more dubious.

In 2012, the Macedonian government signed and ratified the Agreement for economic and technical cooperation on infrastructure with the Government of the People’s Republic of China. In 2013, based on this agreement, parliament passed the Law on Realization of Infrastructure Projects for Construction of Road Section Miladinovci–Shtip and Road



Kichevo-Ohrid highway

Photo Credit: IDSCS

Section Kichevo–Ohrid. This questionable legal maneuver, like in Montenegro, was designed to do an end-run around existing laws on public procurement that had been put in place in accordance with the EU’s acquis.

Unlike in Montenegro, however, evidence of mass corruption ended up bringing down the government of Nikola Gruevski. In 2015, Zoran Zaev of the opposition Social Democratic Union of Macedonia (SDSM) published hours of wiretapped conversations implicating the government, including Gruevski himself, in attempting to pocket provisions from the deal. Instead of getting kickbacks through favored firms as subcontractors, corrupt officials seem to have been trying to skim directly off the top.

Zaev successfully formed a new government in May 2017, and Gruevski

subsequently fled to Hungary and was given asylum even as charges were brought against him at home. Though Zaev’s government turned a leaf in Macedonian politics, with genuine attempts to bring democratic accountability and good governance practices to the country, it is notable that Zaev himself felt like he had to finish the highway project. Given sunk costs, he may not have had any political alternative. But it is also worth noting that the project’s costs did spiral well beyond original projections, and that Sinohydro, which has a track record of profiteering from questionable cost inflation, has not come under special scrutiny under the current government. The ongoing relationship with a behemoth like China is ultimately too important for a small Balkan country to challenge.



Kichevo-Ohrid highway



Serbia

The report on Serbia's sale of the mining and smelting complex RTB Bor to the Chinese company Zijin, by the Center for Contemporary Policy (CCP) in Belgrade, is more circumspect about *cui bono*. But what comes through clearly in the account is that the answer is almost certainly not the Serbian people.

The parallels with the already-discussed case studies stand out. RTB Bor was a Yugoslav-era conglomerate that was profitable through the 1990s. Located in a region rich in copper and precious metals, it was a long-standing bulwark of the Serbian economy. As the 2000s dawned, however, mismanagement and lack of investment had taken their toll. What had once been a critical national asset turned into a massive drain on Serbian state resources. Since liquidating the company was never considered feasible, given that entire towns and villages in the Bor municipality depend on its existence for its livelihood, the government turned its sights on privatization. Investors, alas, never showed up, scared off by the company's aging machinery and plant, the low price of copper at the time, and the company's debt totaling some \$1 billion.

In 2009, Serbia tried to turn the plant around by plowing resources into it. But by all accounts, this process, too, was riddled with

corruption, with some \$430 million invested in rehabilitating the plant with almost nothing to show for it after several years. The details of what exactly happened to these funds remain obscure, but the aging plant was polluting so severely even after these "investments" that output had to be cut back by 60 percent.

It was, coincidentally, also around 2009 that the Serbian government started making overtures to China. Then-president Boris Tadić went to Beijing and signed both the Joint Statement on Establishing Strategic Partnership and the Agreement on Economic and Technical Cooperation in the area of Infrastructure. These two agreements, amended several times since, have served as the basis for a burgeoning, though opaque, relationship between the two countries. In 2019, Serbian leaders announced that Chinese investments in Serbia would soon amount to \$10 billion. No details were given as to where this figure comes from. Given that it doesn't seem to figure fully in the country's balance of payments, corruption at the highest levels is suspected by civil society and anti-corruption activists.

RTB Bor was finally sold to Zijin in the second half of 2018, after a brief but once again opaque public tender was announced. In the run-up to the tender, government officials publicly pushed the idea that there was no alternative to China for the firm's salvation.

Therefore, it may come as a shock to Serbian voters that two other firms—a Canadian-Finnish fund and a Cypriot firm, likely backed by Russian money—did throw their hats in the ring for the purchase. They both lost out, even as Zijin seems to have not promised to fulfill all the requirements enumerated in the tender.

Further muddying up the waters is the fact that Zijin separately also bought rights to the newly-discovered significant deposits of copper and gold at Cukaru Peri, near Bor—a deal that was announced only five days after the tender. Zijin took over a Canadian firm that had won majority rights from the Serbian government several years earlier. Shortly after that, Zijin also purchased the remaining minority rights from an American firm.

The report's writers underline that there is no concrete evidence that Serbian authorities were benefiting from all of this. Still, it is hard

to believe that they were unaware that the Chinese were set to acquire control over a very complimentary asset for RTB Bor. At minimum, this fact raises further questions about the government's seeming eagerness to give the deal to the Chinese over rival bidders.

The report also underscores how the terms of the undisclosed agreement almost certainly don't include adequate regulatory oversight. Problems, including water and air pollution, and even damage to homes in neighboring villages from irresponsible use of dynamite around the mines, continue to crop up, but Serbian authorities have either dragged their feet to address them or have actively ignored them. Protests around Bor have recently spilled over to the streets of Belgrade, with pointed questions being asked about why the Serbian government is shielding foreign companies.



Air pollution in the mining town of Bor in eastern Serbia

Photo Credit: Stefan Veselinović and Jovana Georgievski



Bosnia and Herzegovina

The case study in Bosnia and Herzegovina (BiH), undertaken by the Centers for Civic Initiatives (CCI), focused on the selection of Huawei as the 4G technology provider by BH Telekom, one of the three main cell phone providers in the country. The report highlights a different kind of weakness prevalent in Bosnia: the existence of “governance gaps” in a profoundly fragmented state. Instead of the government signing bilateral trade agreements with Beijing, the lack of transparency from outdated legislation and byzantine governance structures gives all the actors — corrupt ethnic politicians and state-backed foreign investors — the room they need to maneuver.

The legal framework regulating telecommunications in BiH was passed in 2003 and has not since been updated. The strategic documents that accompanied the upgrade to 4G were not well specified. Furthermore, BiH still hadn’t promulgated a new Law on Electronic Communications and Electronic Media, aligned with the *acquis*, as required by Bosnia’s prior agreements with the EU.

But even had better laws been in place, other problems would have presented challenges. The way the public tender was pushed through left much to be desired. Though Bosnia’s telecommunications sector is not bound by its Public Procurement Law, BH Telekom, a state-owned enterprise, should have done much more to make the process of choosing



BH Telecom sign in Sarajevo

Photo Credit: CCI

a hardware provider more transparent. Instead, the company proceeded per its internal procurement rulebook, which falls short of existing transparency legislation already on the books. The report's authors note that the tender itself featured one notable maneuver — the changing of terms mid-process, introducing the requirement that bidders include a provision for the “purchase of the existing equipment.” This put Huawei on top over Ericsson Nikola Tesla, whose offer had previously made the most financial sense.

It's worth noting that the paper looks at Huawei's role in rolling out 4G rather than 5G technology in BiH. And while the fact that Huawei is deeply intertwined with the Chinese state has been raising alarms for some time now, it was the rollout of the next generation high-speed networks that prompted the

Trump administration to elevate the issue. Before then, the use of Huawei routers by telecom providers, while of concern to specialists, was not the political red flag it has since become. Nevertheless, as the report makes clear, there were legitimate security concerns about Huawei even with the 4G technology, and none of these concerns seem to have been very high on the list of those making the relevant decisions.

Taken all together and given that BH Telekom has long been among one of the prizes of patronage politics in Bosnia, it is not too difficult to discern the outlines of possible back-room maneuvering helping secure the win for China. This case study points to the same glaring vulnerability that all but defines the region: a governance pattern rooted in a deep tradition of patronage.



Telecoms infrastructure procured from Huawei by BH Telekom

Photo Credit: CCI



What is to be done?

To understand a problem correctly should not imply making excuses for it. The danger of defining corruption as deeply embedded in a society's governance traditions is to tempt the reformer to throw her hands up in despair. What's the point of trying if it's all cultural?

The good news is that transparency generally polls well, while business as usual does not. The bad news is that the influx of cheap Chinese money and the attendant palpable bumps it gives to the economy in the immediate term helps mask the fact that entrenched elites are practicing business as usual. Add to this that elites, especially but not only in Serbia, actively promote the narrative of China-as-savior and downplay the positive contributions coming from the West.

Recent regional polling by CIPE shows that while most respondents across the region felt like there was no level playing field for businesses in their countries, most felt that public funds were being misappropriated and misspent. In all the countries surveyed, those who saw problems with their countries' respective economies tended to have negative attitudes towards China.

However, there have been upticks in positive impressions of the business climate in both

North Macedonia and Serbia. In North Macedonia, negative attitudes towards European integration — presumably boosted further since the survey by yet another delay in opening accession negotiations — correlated with a positive outlook on China's involvement in the country's politics and economy. And perceptions in Serbia that China was the largest source of economic support — grossly false perceptions, of course — increased by more than 4 percent.

Some have suggested that the goal should be to alert partner governments to the dangers of doing business with China and to mount better public diplomacy campaigns to communicate the benefits of closer association with the West directly to citizens. This is not likely to be effective. Elites in all these countries are to varying degrees engaging with China with their eyes wide open, either from expediency or for darker, more self-serving reasons. And voters, by and large, are fully aware of what is going on. Sympathy for China can be seen as a proxy reaction to the stalling of European accession. The pull of the West remains potent, but the belief that integration is possible has taken a beating.

Instead, any public diplomacy efforts need to be more pointed. Understandably, the EU itself is hesitant to bludgeon what are seen as legitimate governments in these countries with accusations of corruption, especially when the examples (as outlined in these

reports) are not illegal. Still, tighter messaging is possible and ought to be coordinated better with civil society actors on the ground. Local and regional media find think tank reports easy to ignore, but a few words by officials highlighting findings can dominate a news cycle and put politicians on the back foot.

The reports themselves provide plenty of available pressure points. In all four case studies, governments exploited loopholes in outdated existing laws on procurement and public tenders to push through less than transparent deals that have left the countries worse off. Furthermore, the projects highlighted in Montenegro, North Macedonia, and Serbia are all having severe issues with environmental degradation. Given that the EU has decided to prioritize green issues and sustainable development practices, it can rightly exert additional pressure on these governments to do better.

And all this needs to be accompanied with truly credible guarantees of eventual

membership in the various Western clubs. Though full European accession may be off the table for all the Western Balkan countries for the foreseeable future, efforts at developing pathways to [economic integration for the region](#)  with the EU need to be pursued energetically. Not only will this raise standards of living, but it will also (over time) raise standards of doing business more generally.

The truth, however, is that none of this will be quick or easy. Corruption recedes only as political development proceeds, and no one has figured out how to “do” political development easily. As the troubled recent history of the formerly communist countries in Central and Eastern Europe demonstrates, the path to a better place is uneven and full of setbacks. Still, the overall record since 1989 is one of unmistakable improvement. For a host of unfortunate reasons, the Western Balkans are behind. None of those means that progress is foreclosed to them.

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