



CHINA AND SERBIA STRATEGIC INVESTMENT?

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Introductory remarks

From September to December of 2021, Foundation BFPE for a Responsible Society implemented a series of activities with the support of the Center for International Private Enterprise (CIPE) with the goal of reexamining the impact of Chinese investment and capital influx to Serbia.

BFPE held workshops with representatives of the business community, think tank representatives, and academia with the goal of mapping the most relevant sectors of the Serbian economy in which Chinese actors are present, as well as the most important Chinese companies present in Serbia. The result of the workshop was a set of recommendations for the Serbian decision makers and business community that would lead to the improvement of the position of Serbian enterprises in relation to the foreign investors, in this case investors from China.

The Belgrade Security Forum panel on the topic of Chinese investments in Serbia was a follow up to the workshops and another tool to broaden the discussion and to present the findings to the broader public. The conclusions from this panel were added to the recommendations that are presented in this publication.

Finally, BFPE organized a discussion with decision makers in Serbia to present them the findings, but also to include their input in the discussion on how to improve the position of the Serbian businesses.

The findings and recommendations in this publication were formulated on the basis of workshops, as well as the panel held within the Belgrade Security Forum. The recommendations were formulated by the program team of the Foundation BFPE for a Responsible Society and the findings represent the views of the authors, and do not reflect the views of individual participants and CIPE.



The impact of Sino-Serbian economic cooperation

Over the last decade, China's presence in the Western Balkans has grown. Serbia has emerged as the focal point of China's presence. Belgrade and Beijing have established a comprehensive strategic partnership, which was formalized in 2016 with a joint statement issued by the two governments.

Since the signing of a framework agreement on economic, technological, and infrastructural cooperation in 2009, China's presence in Serbia has grown significantly. The agreement served as the foundation for infrastructure projects backed by Chinese banks and implemented by Chinese firms. Sino-Serbian cooperation predates Beijing's Belt and Road Initiative, which was launched in 2013. Since the first decade of the twentieth century, the same template that China promotes through its global strategic foreign policy initiative has been used in cooperation with Serbia. It has also facilitated cooperation in various fields. In Serbia, China has a strong presence in economy, politics, as well as digitalization and security. China has also had an impact on the Serbian environment, and its increased presence is the primary reason for several protests led by activists in Serbia, both locally and nationally.

The real benefit for the overall Serbian economy, as well as the impact of Chinese investment on Serbian businesses, has also been questioned. Chinese investments and projects are frequently motivated by the desire of national level decision makers to accelerate Serbia's economic development. These projects frequently disregard the needs of local communities and businesses. Another issue is the growing foreign trade deficit. Despite the fact that both Serbian exports to China and Serbian imports from China are on the rise, the Serbian economy has yet to significantly benefit from the close relationship, and the Chinese market remains inaccessible to the majority of Serbian-owned businesses. Finally, what Serbian businesses lack is the opportunity to receive the same treatment as foreign investors, specifically Chinese investors. Domestic regulatory frameworks have prioritized foreign investors by providing, among other things, subsidies and tax breaks, which Serbian firms have not received.

Understanding the case of Serbian-Chinese cooperation is essential for understanding the Chinese presence in the region. The Serbian example demonstrates how increased cooperation can be detrimental in the long run if there are no control mechanisms, clear accountability of involved actors, and the necessary level of respect for democratization processes, rule of law, transparency, accountability, and respect for human freedoms and human rights.

On the other hand, there are obvious benefits to working with China, as well as opportunities. However, the implementation of the aforementioned rules and standards, as well as consideration for the needs of local communities and businesses, which are frequently overlooked in favor of the foreign investor, must be of the utmost importance.

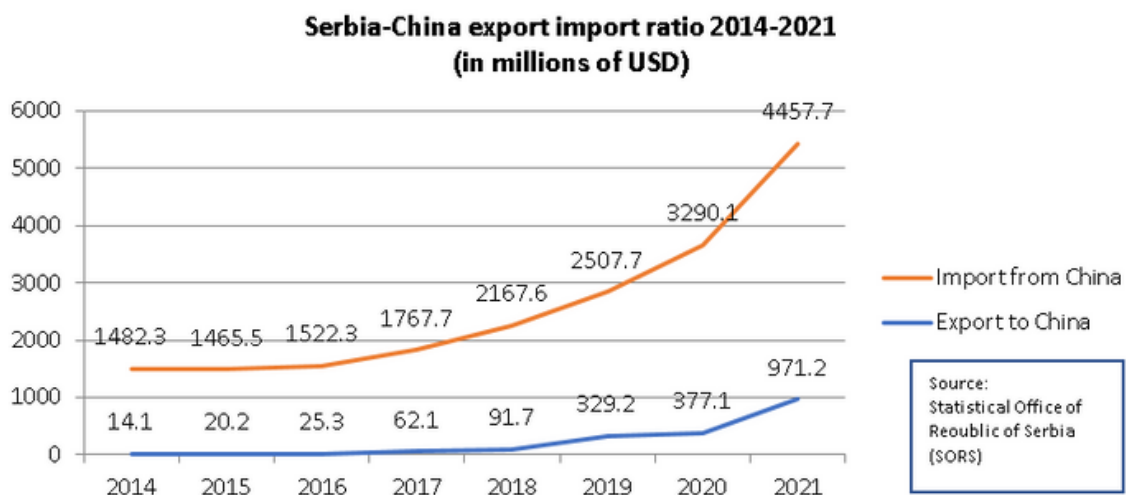


Main characteristics of economic cooperation between Serbia and China

There are several important aspects of economic cooperation between Serbia and China. Each of those aspects has brought certain benefits for Serbia, but it is important to put it in the context to see a full picture and to understand the real level of Chinese impact on the development of the Serbian economy.

Foreign trade exchange

The Chinese market is frequently presented as an opportunity for Serbian export. Close bilateral ties have benefited the overall level of foreign trade exchange between the two countries. Since 2012, there has been consistent growth in this sector, but the fact remains that Serbia imports far more goods from China than it exports.

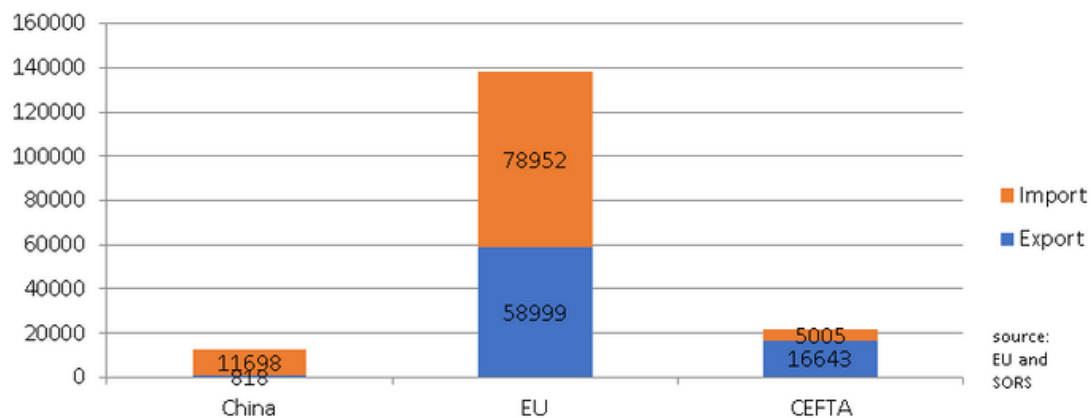


A significant increase in Serbian exports to China occurred in 2019, when exports increased from 91,7 million Euros to 329,2 million Euros. But, in order to comprehend this increase in value, we must first understand that in 2018, the Chinese mining conglomerate Zijin Mining purchased the Serbian Mining and Smelting Combine in Bor. This is significant because the increase in exports was caused by an increase in copper exports from Serbia to China. Serbia exported refined copper worth \$23.5 million USD in 2018, and after Zijin purchased Serbia's largest copper mine, the export increased to \$263,5 million USD. This means that the increase of total export value is not of any significant benefit to Serbia, given that the company that is making the profit from the increase of export is a Chinese-owned company.

Overall trade relations must be viewed in the context of Serbian trade exchange. When we compare export and import figures to and from China with those from the CEFTA region or the EU, we see that China lags far behind.



Serbian export-import from 2015 to 2019
(in million of Euros)



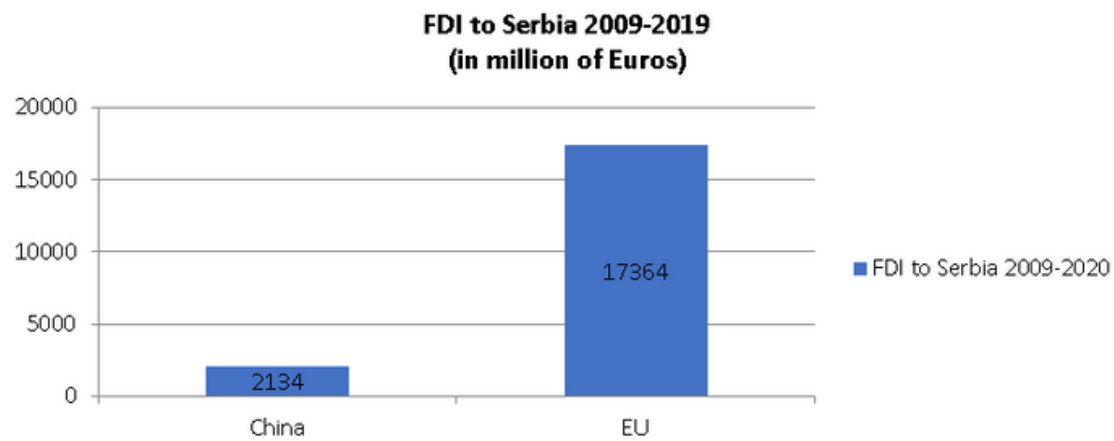
While it is undeniable that foreign trade exchange between Serbia and China is increasing, it still lags far behind the most important partners, the EU and neighboring countries that are members of the CEFTA free trade agreement. This is an indication that the additional value for the overall Serbian economy, particularly that derived from goods exports, is still obtained from cooperation with European and Western countries.

The fact that the majority of Serbian export from Serbia to China is the export of Chinese companies has also been a challenge for the Serbian economy. In 2020, the most important exports from Serbia to China were copper, silver, and copper products from the Chinese-owned Zijin mines in Bor.

This is an indication that the Chinese market remains closed, which may change now that Serbia and China have agreed to sign a free trade agreement by the end of 2022. Still, the question remains as to what the true impact of the agreement will be, and whether the agreement was signed to improve the position of Serbian companies or to remove the last barriers for Chinese goods coming from China.

Foreign direct investment

Another aspect of economic cooperation frequently emphasized by Serbian officials is foreign direct investment from China and Chinese companies. According to data provided by the National Bank of Serbia, Chinese FDI in Serbia totaled slightly more than 2,1 billion Euros between 2009 and 2020. On the other hand, during the same time period, EU countries invested 17,5 billion Euros. Nonetheless, Serbian political officials frequently communicate that China is investing far more than it is. This misinformation is spread primarily by Serbian political leaders, and it is based on the fact that China is lending money to Serbia to fund infrastructure projects. According to the author's research, by the end of 2021, China and Serbia will have agreed on and signed contracts for infrastructure projects totaling nearly 8 billion Euros. All of those contracts are based on preferential loan agreements, which means Serbia will have to repay them all, including interest and other expenses (loan service, penalties if funds are not withdrawn in the predicted dynamic, and so on).



Another source of concern about the rising influx of Chinese capital is that it can be described as corrosive capital (in a significant capacity). "Corrosive Capital is financing, whether state or private, that lacks transparency, accountability, and market orientation," according to one definition. In the case of Serbia, this means that China and Chinese companies are frequently chosen for the implementation of a specific project (usually financed by Chinese loans), without any tender procedure or adherence to competition rules. Furthermore, some of the projects (Smederevo Steel Mill, Bor Mines, Zrenjanin vehicle tire factory) have raised serious environmental concerns, and it is difficult to hold anyone accountable for the consequences. Third, in terms of market orientation, and once again related to long-term environmental protection, China has provided the tools for the modernization of the coal-fired power plant Kostolac, as well as the construction of a new block of the same facility. Financial agreements between Serbia and China will undoubtedly benefit the development of Serbian infrastructure, particularly traffic infrastructure, in the short term. Still, in the long run, the fact that Serbia is using Chinese financial means to upgrade its coal-fired power plants, and that Chinese FDI has had an impact on the well-being of the Serbian environment, is concerning and should be followed by the implementation of control mechanisms.

The third aspect of economic cooperation is the (non-refundable) grants that China is providing to Serbia. From 2009 to 2020, China has provided 78,8 million Euros worth of grants to the Republic of Serbia. This figure is incomparable with the EU's provided funds. Until 2019, the EU has provided 3,7 billion Euros of grants to Serbia through various instruments, with additional funds (93,4 million Euros) being pledged through COVID-19 Relief and Economic and Investment Plan for the Western Balkans.

The issue of the rising number of loan agreements

Foreign exchange disparities and corrosive capital from FDI are not the only obstacles to China-Serbia economic cooperation.



Serbia and China, as previously reported, have signed preferential loan agreements totaling more than 8 billion Euros. All of these agreements are Chinese bank credits to Serbia, putting a strain on the country's public debt and budget. Serbia has managed to keep its debt under control, with the country's public debt standing at 56,9% of GDP in December 2021. Foreign debt accounts for 57.8 percent of total public debt in the country. In December 2021, Serbia's foreign debt was estimated to be approximately 19,7 billion Euros, with 1,6 billion of that amount owed to Chinese banks (Export-Import Bank). So far, Serbia has been able to keep its microfinances under control and avoid falling into debt. Serbian foreign debt may bear a heavier burden in the coming years as the total amount of loans increases as a result of credits obtained from Chinese banks.

Examples of corrosive capital: The impact of Chinese investment on environmental protection

In January 2021, 26 European Parliament members expressed concern about China's growing influence in Serbia. One of the main concerns raised by MEPs is that Chinese investments are having a negative impact on the Serbian environment. Those concerns expressed in Brussels have drawn significant international attention to an issue that has been raised by both local and national activists in Serbia for several years.

According to a report published in December 2019 by the Global Alliance on Health and Pollution, Serbia is ranked ninth in the world for the highest rate of deaths attributed to air pollution. According to the report, Serbia is the highest-ranked European country. China is linked to this issue in a number of ways. Specifically, Chinese investments in Serbia have not met environmental standards. This is the case when we discuss Chinese FDI in the Smederevo steel mill purchased by the Chinese Hesteel Group, the purchase of Bor mines by Chinese Zijin Mining, and the construction of a vehicle tire factory in Zrenjanin by Chinese Linglong.

In the case of the Smederevo steel mill and the Bor mines, the main issue is the increased production caused by Chinese company purchases. Both companies were managed by the Serbian government before being sold and were on the verge of collapsing and shutting down, resulting in the loss of over 10.000 jobs. This would have a significant negative impact on the local economies in those areas, so the Serbian government looked for a partner extensively. As a result, the Chinese companies' acquisition was viewed as a way to keep those companies afloat while also protecting domestic workers' jobs.



However, Serbia did not guarantee that the new owners would take the necessary steps to upgrade the existing facilities, making them more suitable for safe production while adhering to current environmental standards before selling those companies. The project's first opponents were from the local level in both cases. Local activists have stated that the companies are harming the local ecosystems, and that the increased pollution is having a negative impact not only on the workers' health, but also on the health of the general population in those areas.

The investment in the Shandong Linglong vehicle tire factory is somewhat different. The first distinction is that the investment in the City of Zrenjanin area is a greenfield investment, which means that the Chinese can pay close attention to environmental standards and build capacity to ensure compliance. Nonetheless, the project's execution was marred by controversy. First, the Serbian government provided free land to the Chinese investor for the construction of the factory. In this case, the Serbian government's policy is to encourage potential and existing investors; however, not all of the 96 hectares of land were planned for construction and have been repurposed for the company's needs. Second, the Chinese company started construction without first obtaining a building permit from the Serbian authorities. The third source of concern was that the study on the new factory's environmental impact was never made available to the general public. It is a legal requirement in Serbia to hold a public debate on such important community documents. While those debates are scheduled, members of the public who are opposed to certain aspects of the Linglong facility's construction are barred from attending. None of this slowed or halted the facility's construction, and it was announced that the first finished product could leave the factory as soon as the end of 2021.

The position of Serbian businesses

The case of the Chinese economic presence in Serbia has been indicative of the overall position of the Serbian businesses towards foreign investors and treatment coming from the national government. The position that the businesses are taking is that no investment can be seen as harmful and malign in its nature. But what the result of the activities within the project shows is that there are no equal standards when it comes to the treatment of foreign investors and the domestic business actors. First and foremost, investments often do not include the needs of the local communities and are defined by the needs of the investor and not local surroundings. Second, often the standards and national normative framework have not been implemented in the case of investors (e.g. the environmental standards), but there are firm rules implemented for domestic businesses. Third, there should be a higher level of engagement between foreign investors and domestic businesses. There are mechanisms already facilitating this connection, but there is much needed room for improvement. Fourth, while there is objective potential for Serbian businesses when it comes to Serbian export to China, that potential has not been met by the capacities of Serbian companies and entrepreneurs, and this can be an opportunity both for the national government and domestic businesses.



In the end, there has to be clear cost-benefit analysis when it comes to attracting investment from China or any other country. If the cost associated with investment to the environmental protection, rule of law, labor treatment, and position of domestic businesses is too high, those investments and projects should be reexamined.

In order to meet the needs of domestic businesses, there should be continuous conversation and discussion among stakeholders on national, but also international level. The needs of domestic business actors have to be clearly formulated, especially the needs of ones from areas with a high level of presence of foreign actors. Those needs also have to be formulated in the framework of national and international standards and norms, because they have the potential to increase the level of Constructive Capital, and limit Corrosive Capital.

How to improve the position of Serbian businesses?

Based on the findings of the research, recommendations for the improvement of the position of Serbian businesses can be implemented in the national framework. Those recommendations can be seen as recommendations directly pointed towards the economic and political cooperation between Serbia and China. In addition to the specific recommendations for businesses in the context of Sino-Serbian relations, some of the proposals cover broader relations between foreign investors and Serbian actors. Consideration of those recommendations and implementation in the national framework would improve the overall position of Serbian businesses and limit the potential for the growth of Corrosive Capital.

Recommendations for limiting Corrosive Capital and encouraging benefits for the Serbian economy:

1. Involvement of the local community on decisions on foreign direct investments and implementation of infrastructure projects.

Investments and infrastructure projects are decided at the national level, without consulting the local community. The needs of the local community are neglected, including the needs of the local businesses.

2. Full implementation of the national legislative framework in economic cooperation with foreign investors.

Although this recommendation should be absolutely applied to all investments and forms of economic cooperation with actors from abroad, based on previous experience in the case of cooperation with actors from China, it is necessary to further indicate the application of this principle. Despite the fact that no investment or other form of capital inflow is bad in and of itself, in order to prevent the inflow of Corrosive Capital and encourage Constructive Capital.



3. Focus on attracting technology transfers from China and defining a different system of subventions that would encourage the process

China is a leader in various areas of new technology development and the transfer of technology to actors in Serbia could be a benefit for both the Serbian business community and the Serbian economy. The system of subventions could be defined so as to be focused on domestic companies that would base their business on the applied technology. It would also mean abolishing the payment of subventions per workplace, and would encourage spillovers in favor of domestic companies.

4. Raising the capacity of domestic entrepreneurs in order to penetrate the Chinese market

Having in mind the high trade deficit that Serbia has with the People's Republic of China, it is clear that there is a lot of space for improving trade cooperation and increasing Serbian exports to the Chinese market. In addition to the previously mentioned technology transfer that would contribute to the development of domestic companies, better promotion and establishment of more coherent mechanisms of cooperation between Serbian and Chinese business actors (through organizations such as the Serbian Chamber of Commerce and the Serbian Development Agency) would contribute to a higher level of Serbian presence.

5. Introduction of cost-benefit analysis when negotiating investments from China

Following the screening mechanism introduced in the European Union, a cost-benefit analysis should be conducted within the relevant institutions to consider the details of investments coming from China, which should include evaluating general benefits for the Serbian economy, what is the impact on the local community, whether there is the possibility of hiring Serbian companies for jobs that would be related to investment. This analysis would also consider the impacts on environmental protection, the socio-economic situation in the local environment and the impact on security. It would be extremely important to conduct this type of analysis in strategically important sectors, such as energy, telecommunications and dedicated industries.

6. Continuation of the promotion of Serbian tourism and attraction of tourists from China after the end of the restrictive measures introduced due to the pandemic

This would give a concrete advantage to this part of the economy and encourage the transfer of capital to local communities in Serbia. Also, additional funds and resources (financial and human) should be invested in the promotion of Serbia through the work of the embassy in Beijing and the work of the Serbian Cultural Center in Beijing.

7. Review of the agreement on economic and technical cooperation in the field of infrastructure between the Government of the Republic of Serbia and the Government of the People's Republic of China from 2009, as well as the annex to the agreement that was afterward adopted

The 2009 agreement represents the legal basis for all infrastructure projects implemented in cooperation between the two countries and with the involvement of Chinese companies. This agreement contributes to the circumvention of tender procedures and represents the possibility of arranging jobs at the bilateral level. The focus should be on the implementation of national legislation, which implies compliance with competition rules, best offer and tender procedures.