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The Economic Effects Of Chinas Belt And Road Initiative On Selected Southeast European Countries

Bachelor Thesis

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List of Abbreviations

BRI	Belt and Road Initiative
CCCC	China Communications Construction Company
CRBC	China Road and Bridge Corporation
CSIS	Center for Strategic & International Studies
EU	European Union
EUR	Euros
FDI	Foreign Direct Investment
IMF	International Monetary Fund
MERICS	Mercator Institute for China Studies
MoU	Memorandum of Understanding
NATO	North Atlantic Treaty Organization
NDRC	National Development and Reform Commission
OBOR	One Belt One Road
OECD	Organization for Economic Cooperation and Development
PRC	People's Republic of China
RMB	Renminbi
UN	United Nations
USD	US Dollars

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1. Introduction

Throughout history, humans moved goods from place to place to each other for mutual benefit. Starting more than two millennia ago Europe and Asia have loosely linked up through paths of trade across both land and sea that are today known as the Silk Roads. These vast networks of trade not only resulted in the exchange of goods, but they also contributed to the transfer of knowledge, skills, technologies, literature, arts, and ideas. For centuries the Silk Road contributed to the development and the prosperity of the countries along the trade routes, contributing to the progress of civilization (UNESCO, 2019).

Through the development of infrastructure in Europe, Asia and Africa China intends to revive the ancient Silk Roads by stimulating trade and improving connectivity throughout Eurasia and beyond (NDRC 2015). First introduced in 2013, by the Chinese President Xi Jinping China's Belt and Road Initiative (BRI) seeks to "promote the economic prosperity of the countries along the Belt and Road [...], strengthen exchanges and mutual learning between civilizations, and promote world peace and development" (NDRC 2015). While the BRI was a vague concept when being announced in 2013, it has become China's primary international economic strategy with the launch of the first landmark projects in 2016. Already very few years after its announcement the BRI has achieved remarkable progress in terms of infrastructure building, promotion of investments and financial cooperation (Zhang 2018, p. 3). According to the World Bank, the BRI includes 72 countries, from China to Southeast Asia, East Africa, the Middle East, and Europe, that account for more than 60 percent of global GDP and 70 percent of global population (Chen and Lin, 2018). The relative monetary volume of the BRI is comparable to the US post-war recovery plan for Europe, the Marshall plan. While the estimated absolute size of the BRI's investment volume is still subject to debates it has already grown bigger than the total investment volume of the Marshall plan. Conservative estimates of the amount of money spent on BRI projects to this date start at around USD 448 billion while the volume of the Marshall plan is estimated at around USD 120 billion at current prices (Kozul-Wright 2019; Barisitz and Radzyner 2017a, p. 9).

This comparison to the Marshall plan is essential and very helpful to be able to classify the possible impacts of the BRI solely through its investment volume. While the Marshall plan had a significant effect on war-torn Europe (Kozul-Wright 2019) and played an important role in the reconstruction of Western economies the potential economic effects of China's BRI initiative are still mostly subject of discussion. But like the Marshall Plan the BRI could also

have significant economic implications, for example, through reducing the infrastructure gap in many developing countries. Furthermore, the initiative is also enjoying growing support in Europe, for example through the expansion of the Chinese-owned port of Piraeus in Greece, the recent move of the Italian government to endorse the BRI (Johnson 2019) or the initiative of China to extend and intensify economic cooperation with 16 Central and Eastern European countries, 11 of them being EU member states, also known as the 16+1 format (Grieger 2018). In contrast, the BRI also has many critics in Europe and around the world which became obvious again after the widespread negative reactions on Italy's move to endorse the BRI in early 2019.

The short- and medium-term effects on large economies like Germany or France that officially have not even endorsed the BRI might be difficult to estimate. Consequently, this thesis will focus on assessing the consequences of the Chinese BRI on smaller South-East European economies using the examples of Montenegro and Serbia. These Balkan countries are profiting from relatively high FDI inflows from China, for example, Montenegro with a planned investment volume of EUR 2.8 billion for two main highways. That accumulates to 72 percent of Montenegro's GDP in 2017. Serbia is also one of the main beneficiaries of Chinese FDI in South-East Europe and has established preferential arrangements, lowering the hurdles for financial and technical assistance from China. To the knowledge of the author no study to this date has examined the project-related effects of the initiative on a European country. And to some extent, the effects on the relatively small euroized European countries Montenegro and Serbia (Petri et al. 2018, p. 4) can provide first insights on possible challenges and opportunities for other European countries that are considering to join or already have joined the BRI and reduce the knowledge gap on this matter. As this thesis examines only the economic effects of the initiative no broad analysis of geopolitical implications or other non-economic effects is conducted.

2. The Belt and Road Initiative

2.1. Announcement

Traditionally every new leader of the People's Republic of China introduces an updated international strategy (Zhang 2018, p. 2). On September 7, 2013, around six months after being elected president at the fourth plenary meeting of the first session of the 12th National People's Congress in Beijing (The National People's Congress of the People's Republic of China 2013). Xi Jinping followed that tradition and introduced the idea of a "Silk Road Economic Belt" during a speech at Kazakhstan's Nazarbayev University (Ministry of Foreign Affairs of the People's Republic of China 2013). A few weeks later president Xi Jinping extended his concept while being on a state visit to Indonesia with the concept of a "21 Century Maritime Silk Road". Together these two strategies were introduced as the "One Belt One Road Initiative", which was later rebranded to the term that is used by Chinese governmental organizations today: the "Belt and Road Initiative" (BRI).¹

His speech in Kazakhstan, titled "Promote People-to-People Friendship and Create a Better Future", marked the first time that the idea of an Economic Belt was introduced to a public audience. The name of the project and the place of its announcement carried a high symbolic meaning. In his speech president Xi Jinping explained that more than 2,000 years ago an imperial envoy was first sent to Central Asia to lay the groundwork for a transcontinental silk trade route between Asia and Europe. Kazakhstan was a major part of the ancient Silk Road which, according to Xi brought peace, unity, mutual trust, tolerance and learning to the countries along the trade route (Ministry of Foreign Affairs of the People's Republic of China 2013).

Furthermore, he explained that in the face of a Chinese economy that is advancing rapidly and strengthening its diplomatic ties to other European and Asian nations the former Silk Road will gain importance again. To further develop those ties and the regional cooperation of Eurasian countries Xi proposed to jointly build a modern Silk Road Economic Belt with other countries for mutual benefit. In his initial statement Xi Jinping also gave a glimpse into how he intended to establish the project: the Belt and Road Initiative should not only consist of

¹ The name "Belt and Road Initiative" is used by the PRC State Council, the Ministry of Foreign Affairs of the PRC, the National Development and Reform Commission of the PRC and Chinese President Xi Jinping at the opening ceremony of the Belt and Road Forum 2017.

infrastructure to increase connectivity and decrease transportation costs but also aim at “strengthening policy communication [...], promote trade facilitation [...], enhance monetary circulation [...] and strengthen exchanges between people [...]” (Ministry of Foreign Affairs of the People’s Republic of China 2013). The BRI is considered to be Beijing’s biggest diplomatic outreach since the opening-up reforms that started in the late 1970s (Casarini 2015, p.1) and the fact that the BRI was already announced before any guidelines or blueprints existed resulted in high expectations in the world community but also has caused cautious reactions since China’s international politics are usually introduced in a more reserved way (Zhang 2018, p.5).

Figure 1: Chinese President Xi Jinping (L) with Kazakh President Nazarbayev (R) during the state visit where the plans for the BRI were first revealed (Source: China Daily 2013).

2.2. Historical Background

According to the National Development and Reform Commission of the People's Republic of China the Belt and Road Initiative “covers [...] the area of the ancient Silk Road” (NDRC 2015). The widely known terms “Silk Road” or “Silk Routes” which are used to introduce the ambitious project were first introduced by the German geographer Ferdinand von Richthofen in 1877 to describe “the historic routes of economic and cultural exchange across Eurasia” (Waugh 2010). While von Richthofen pictured the east-west trade two millennia ago as a very specific route many historians today agree that his focus on the trade of silk between Han China and ancient Rome was too limited. In fact, the trade routes were very dynamic and not only restricted to one trade route but continuously changing over time (see figure 1). This dynamic is also to some extent, valid for the trade routes proposed by modern China, as there is no single trade route but instead the BRI is “open to all countries” (NDRC 2015) and can be seen as a network of connectivity, infrastructure and trade routes. The Silk Road was also not only about the overland trade of silk, spices, iron, olive oil, etc. but also about cross-cultural exchange, movement and resettlement. In addition von Richthofen's concept can be extended to the Bronze and Early Iron Ages on the one hand and to the European Age of Discovery from the 15th to 17th century (Waugh 2010). In the 2nd century BCE, when the Huns ruled over most of Inner Asia Chinese goods were transported from the Eastern boundaries of the Hun empire to Central Asia and even to the Mediterranean area as a result of a stimulation of trade caused by the fact that most of Inner Asia was controlled by one empire (Waugh 2010).

Figure 2: A map of the major routes and sites of the ancient Silk Road (Source: Waugh 2010)

2.3. The Official Framework of the BRI

Van der Putten et al. suggest that the project can be best described as a “broad conceptual framework for policies contributing to greater economic integration within Asia, between Asia and Europe, and between Asia and Africa” (van der Putten et al. 2016). Today the Belt and Road Initiative is the prestige project of China and especially its president Xi Jinping but when it was first announced it was not more than a “vague concept” (Zhang 2018) to increase cooperation with China’s geographical neighbors. Zhao Lei, a professor of international strategic studies at the party school of the Central Committee of the Communist Party of China summarized the evolution of the project: “While the year 2013 marks the proposal of the BRI, 2014 witnesses careful policy deliberation of it, 2015 highlights top-level designing, and 2016 marks substantial international consensus through the launch of landmark projects” (Xinhua 2017).

The top-level design was manifested in a White Book, published on March 28th, 2015 by the National Development and Reform Commission, the Ministry of Foreign Affairs, and the Ministry of Commerce of the People's Republic of China as the “Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road” (from now on referred to as the “White Book” on the BRI). In this White Book the BRI is described as the answer to the slow recovery of the world economy from the global financial crisis in 2007/2008, uneven global development and growing uncertainties in the international trade and investment system. According to the the document China wants to “embrace a multipolar world, economic globalization, cultural diversity [...] and uphold the global free trade regime” through the initiative (NDRC 2015). Furthermore, it states that the systematic and joint building of the BRI “is in the interest of the world community” (NDRC 2015) through the promotion of economic prosperity, cooperation, mutual learning and world peace. This should be achieved through an increase of connectivity between Asia, Europe and Africa. These connectivity projects are supposed to expand market potential, consumption, investment and create employment in the local economies along the Belt and Road (NDRC 2015).

To achieve these ambitious targets the White Paper identifies five fields of priority:

- First, the coordination of common policies is described as an important factor for benefiting from the BRI for example through the cooperation in large-scale projects.

- Second, a key factor of the initiative and the focus of this thesis is the improvement of the connectivity to form a transcontinental infrastructure network in terms of passageways, port infrastructure and energy infrastructure while paying respect to the territorial sovereignty of each nation.
- Third, China motivates countries participating in the BRI to remove or lower tariff and non-tariff barriers to improve and facilitate trade and investment. In the White Paper China specifically encourages Chinese companies to “participate in infrastructure construction in other countries along the Belt and Road” (NDRC 2015).
- Fourth, the financial integration which, among other things, formulates the goal of creating international development banks and funds to access financing but also allow private and commercial funds to invest in key projects of the initiative.
- Fifth, the Chinese side wants to strengthen the bonds between the people of the BRI countries through academic and cultural exchanges. This is also described as a key priority but will not be analyzed very intensively in this thesis since the author will focus on the economic aspects of the BRI (NDRC 2015).

2.4. Literature Review

2.4.1 Geography of the BRI

Although the Chinese government speaks of the initiative as a “systematic project” (NDRC 2015) there is no official definition (Cosentino et al. 2018, p. 15) of the scope of the BRI. In fact the Chinese White Paper it is stated that the BRI is “open to all countries” (NDRC 2015) even if they are not situated in the geographical area of the ancient silk road. Moreover, previous studies have shown that the geographical and economic boundaries of the initiative seem to change with the transformation of a countries' ties with China (Cosentino et al. 2018, p. 15) and are “still being deliberated” (Ruta et al. 2019, p. 12). As of July 2019 China has signed 171 Belt and Road cooperation agreements (Wenqian 2019) with 125 national governments (Ruta et al. 2019, p. 12) and international organizations.

As there is no official list of countries that participate in the BRI, in this thesis, following the the example of the World Bank, 71 countries (Soyres et al. 2018) that are geographically located along the Belt and Road economic corridors will be considered as participating countries (see table 1). From now on these countries will be referred to as the BRI's “corridor economies” . The economic corridors of the BRI were defined in the Chinese White Paper on the Belt and Road Initiative as: (i) the New Eurasian Land Bridge Economic Corridor reaching from Western China to the Netherlands, (ii) the China - Mongolia - Russia Economic Corridor, (iii) China - Central Asia - Western Asia Economic Corridor, (iv) China - Indochina Peninsula Economic Corridor, (v) the Bangladesh - China - India - Myanmar Economic Corridor, (vi) the China - Pakistan Economic Corridor and (vii) the Maritime Corridor (NDRC 2015). In 2018 these 71 participating countries (including China) accounted for 60% of global GDP and 70% of the world population (Chen and Lin 2018, p. 2).

Region	Corridor Countries
Central And Western Asia	Armenia, Azerbaijan, Georgia, Iran, Kazakhstan, Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan, Uzbekistan
East Asia & Pacific	Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Mongolia, Myanmar, Philippines, Singapore, Taiwan, China, Thailand, Timor-Leste, Vietnam
South Asia	Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka
Central and East Europe	Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, North Macedonia, Moldova, Montenegro, Poland, Russian Federation, Serbia, Slovak Republic, Slovenia, Ukraine
Middle East & North Africa	Bahrain, Djibouti, Egypt, Arab Rep., Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, Turkey, United Arab Emirates, West Bank and Gaza, Yemen, Rep.
Sub-Saharan Africa	Kenya, Tanzania

Figure 3: The 72 “corridor economies” of the BRI as defined by de Soyres et al. (2018)

Resulting from the lack of official lists regarding the scope of the BRI it is difficult to identify the number of all projects as China also did not publish any data collections on project-based investment. The basis for identifying the project volume of the initiative is the “Reconnecting Asia” database of the Center for Strategic & International Studies (CSIS), an American non-profit organization. After reviewing the existing literature and sources this is the most complete and up-to-date collection of BRI projects. The data was collected using an open-source methodology, examining relevant sources like national governments and its agencies, regional development banks, news articles and published project contracts. Using this methodology, the CSIS found that there are 369 Chinese-funded projects in the economic corridors of the Belt and Road Initiative most of which are related to transportation via rail, road, sea, air or energy infrastructure (McCalpin 2019).

Figure 4: A spacial overview of some major BRI projects in Africa, Asia and Europe (Source: Barisitz, Radzyner 2017a).

2.4.2 Investment Volume

Prior research of the Asian Development Bank suggests that the key countries of the economic corridors that China wishes to target with the BRI have an infrastructure gap of USD 330 billion to USD 459 billion (Shen and Chan 2018, p. 8). According to other sources the needed investment to fill this infrastructure gap even amounts to an estimated USD 730 billion (Barisitz and Radzyner 2017a, p. 10). Shen and Chan, conclude that this is a gap that “China could never solely fill up” (Shen and Chan 2018, p. 8), but it might be possible that they underestimate the ambitions of the initiative. Depending on the source the total volume of the BRI varies significantly. For instance a study conducted by a team of the Austrian National bank in 2017 suggests that China has the intention to reach an investment volume of up to USD 4 trillion (Djankov and Miner 2016, p. 8). Hurley et al. (2018) even expects an USD 8 trillion investment volume over the next 20 years (Hurley et al. 2018, p. 2). But as previously explained no exact number can be given on the total investment volume since it is changing over time due to the loose and open framework of the BRI. However, a large number of existing studies in the broader literature, including the study that suggested the ambitious goal of USD 4 trillion, have examined a huge difference in the ambitions of the BRI and the actual implementation of projects. Often there are reports of new BRI-related deals on new infrastructure projects that are, in reality, only “based on vague Memoranda of Understanding (MoUs)” (Eder and Mardell 2018). Reasons for that are most likely the interests of local politicians to display economic growth and development while Chinese officials that want to increase and spread the hype surrounding the BRI (Eder and Mardell 2018).

Coming back to the estimated investment volume of the BRI, as of end-2016 Barisitz and Radzyner (2017a) report an investment volume of projects that are already in development of around USD 290 billion (Barisitz and Radzyner 2017a, p.19-20). A very recent report conducted by the World Bank suggests that from end-2016 to early 2019 the actual investment volume has nearly doubled and the BRI investment in all sectors totals to USD 575 billion today (Ruta et al. 2019, p. 13-14). However, existing literature shows that these investments have strong implications on public debt, especially in small and/or developing economies. Rising debt distress and also debt default with severe consequences is becoming a more and more important issue in recent literature and will be thoroughly examined in the course of this thesis.

2.4.3. China's Motivation

The Chinese White Paper for the BRI lays a strong emphasis on the mutual benefits for all participating countries and for third countries which are not officially a part of the BRI scheme. And of course, the high investment volume will most likely have effects on BRI countries and the world economy. The White Paper describes the effects of the BRI as exclusively positive and does not mention any aspects that might pose potential risks, liabilities or uncertainties to BRI countries. The essence of the vision is that every country that participates in the “mutually beneficial” (NDRC 2015, p.2) initiative will profit from a “win-win cooperation that promotes common development and prosperity [...], peace and cooperation, openness and inclusiveness, mutual learning and mutual benefit” (NDRC 2015, p.3). And unquestionably, there are various positive implications that already are or will be caused by the ambitious BRI. As previously explained, one key are of the BRI is the creation of networks and economic corridors (NDRC 2015, p.2). This will bring together China, Asia, Africa and Europe through the construction and improvement of transportation links (Barisitz and Radzyner 2017a, p.11) and the previously mentioned reduction of infrastructure gaps in many developing countries (Shen and Chan 2018, p. 8).

But of course there are also strong benefits for the Chinese side: as the biggest trading nation in the world it is in the interest of China, and of course also in the interest of the world economy, to reduce trade costs through improved infrastructure (Djankov and Miner 2016, p. 7). Additionally, many authors suggest that the BRI has the core purpose of “reviving the Chinese economy” (Casarini 2015, p. 3) which is changing from the formerly successful export-oriented growth model to a consumption- and outward investment-based growth model. According to Casarini (2015) BRI projects are expected to decrease overcapacities, restructure various sectors and find new markets for Chinese products (Casarini 2015, p. 3). Especially companies that have boomed during the thrive of China's economy want to expand and are looking for new markets and opportunities across the globe. This is also displayed by the fact that more than two thirds of all BRI-related loans are only given on the condition that substantial parts of funds are used to employ Chinese workers, buy Chinese equipment and to engage Chinese companies in the planning and construction phases of the projects (Djankov and Miner 2016, p. 7). If these requirements are fulfilled the Chinese loans come extremely fast, have long maturity periods and low interest rates but can be a huge risk to the fiscal stability of a country (Grieger 2018, p. 7). According to a report conducted for the European Commission this danger of low debt sustainability could be intensified by the fact that some projects are only implemented because of the easily accessible Chinese funding

while little attention is paid on the actual economic returns of the specific projects (Cosentino et al. 2018, p.17).

In addition to that, a EU study concluded that China's objectives behind the initiative are different from the content of the Chinese White Paper on the BRI. According to the study the objectives are (i) the stimulation of Chinese products, construction capabilities and engineering technology, (ii) gaining control of logistics chains to Europe, (iii) increase the use and the internationalization of Renminbi (RMB), China's national currency, (iv) develop the Chinese hinterland to achieve a more balanced development throughout China and (v) secure oil and gas supply from Central and South East Asia (Cosentino et al. 2018, p.15). A Harvard study goes even further and suggests that China is using the BRI to advance its national interests. It describes China as "the world's leading practitioner of geo-economics" (Parker 2018, p. 6) – adept at using its economic power, especially in terms of money lending to create dependencies and to project its global power ambitions.

The skeptical response towards many especially Western countries to join the initiative and the often critical public reporting on the existing Belt and Road projects shows that many national governments see a variety of risks and potential disadvantages of participating in the initiative. The important question is if China's objectives behind the initiative could diminish the undeniable positive implications that usually come with infrastructure spending and trade liberalization. In the following chapters of this thesis the author will critically reflect on the positive but also the negative effects that the BRI might have on participating countries on the example of Montenegro and Serbia.

2.5. The BRI in Europe

2.5.1. Europe's Role in the BRI

Europe is located at the Western endpoint of the major economic corridors of the Belt and Road Initiative. As a result European countries may profit from increased trade possibilities and increased infrastructure (Barisitz and Radzyner 2017b, p. 71) resulting in potential positive economic effects and also access to Chinese Belt and Road funding (Casarini 2015, p. 2). Although there is great potential for European economies the EU still lacks a finalized unified strategy towards China's Belt and Road Initiative (Cosentino et al. 2017, p. 16). Instead, many European countries have signed numerous MoUs with China (see figures 5 and 6) on either (i) the general framework of the BRI or (ii) agreements related to specific issues of the BRI (Cosentino et al. 2017, p. 30). As can be seen in table 1 the overwhelming majority of these general MoUs on the general frameworks of the BRI were being signed by Eastern and South Eastern European countries while many Western European countries only signed MoUs on some transport-related issues.

Country	General framework of cooperation under the BRI	MoU on transport/ infrastructure/ customs cooperation	MoU on other topics
Austria			2017
Belgium			
Bulgaria	2015	2016	
Croatia	2017	2016	
Cyprus	2017		
Czech Republic	2015		2016, 2017
Denmark			
Estonia			2015, 2017
Finland			
France			2017
Germany		2016, 2017	
Greece	2017, 2018		2017
Hungary	2015	2014, 2015, 2017	2017
Ireland			2017

Italy	2019		2017
Latvia	2016	2016	
Lithuania		2016	
Luxembourg			
Malta	2018		
The Netherlands		2017	
Poland	2015	2016, 2017	2015, 2016, 2017
Portugal	2018		
Romania	2015		
Slovakia	2015		
Slovenia			
Spain			
Sweden			2015
United Kingdom			2016

Figure 5: MoUs signed by EU member states and China (Source: Cosentino et al. 2017 and author's analysis)

Country	General framework of cooperation under the BRI	MoU on transport/infrastructure/customs cooperation	MoU on other topics
Albania	2017	2015	2017
Belarus		2017	2016, 2017
Bosnia and Herzegovina	2017		2017
North Macedonia			2017
Moldova			2017
Montenegro	2017	2015	2017
Norway			2017
Serbia	2015	2014, 2015, 2017	2017
Switzerland		2017	2017
Turkey	2015	2017	2017
Ukraine			2017

Figure 6: MoUs signed by European non-EU member states and China (Source: Cosentino et al. 2017)

Two years before the official announcement of the BRI, China and 16 countries from Central and Eastern Europe created the “16+1 Format”, a framework to foster economic integration and diplomatic cooperation between the Chinese side and the EU member countries of Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia as well as the Balkan nations of Albania, Bosnia & Herzegovina, North Macedonia, Montenegro and Serbia (Ministry of Foreign Affairs of the Republic of Latvia 2017). Although the initiative started before the BRI was officially announced the 16+1 format is strongly associated with the initiative as a basis to promote China’s objectives in Eastern and South Eastern Europe (Grieger 2018, p. 2). Following the yearly 16+1 summits China’s economic presence and especially its investment in the region have accelerated (Barisitz and Radzyner 2017b, p. 71). According to the BRI database of the Mercator Institute for China Studies (MERICS) the region profited from nearly 4 billion USD of Chinese financing for projects that are already completed plus, depending on the source, 7 billion USD to 10 billion USD of funding for planned projects (Eder and Mardell 2018). This analysis is supported by an EU study from 2015 that found that there is a strong concentration of Chinese investments and loans in the border regions of the EU, especially in the Western Balkans (Cosentino et al. 2017, p. 36). But often these loans are incompatible with EU public procurement and bidding regulations and require state guarantees that fall under Chinese jurisdiction with limited chance of a positive result for the lending country (Grieger 2018, p. 7).

Figure 7: An overview over the 16+1 member states and their EU membership (Source: Author’s analysis visualized with Mapchart.net)

2.5.2. Southeastern Europe and the BRI

Through their geographical position at the “final part of [the] Maritime Silk Road” (Barisitz and Radzyner 2017b, p. 71) Southeastern Europe has been the main recipient of BRI funding in Europe to this point of time (Casarini 2015, p. 3). In contradiction to the Central and European 16+1 countries, most Southeast European countries have less access to EU funding as they are no EU member countries and can only rely on limited funding from the union. Although there are several funding instruments for the region there remains a financing gap especially for the Western Balkans (Schneidewind et al. 2011, p. 22-23). As a result the countries are relying more on Chinese funding which appears to be a less complicated way of financing than EU structural funds: the approval processes are streamlined, the Chinese government backs the financing deals and pledges to rapidly implement the related projects (Sanfey et al. 2019). These Chinese investments have the potential to contribute strongly to stimulating the region's growth and help to overcome its peripheral position in Europe (Barisitz and Radzyner 2017b, p. 72) and become the Chinese gateway to Europe (Casarini 2015, p. 4) .

As stated above, China is taking advantage of the financing gap and upgrading or acquiring infrastructure that is important to fulfill the infrastructural needs of the BRI. One of the flagship projects is the railway connection between Belgrade and Budapest with a budget of EUR 2 billion (Barisitz and Radzyner 2017b, p.78). The railway is part of one of the most important sections of the Belt and Road initiative. Located in Southeastern Europe there is the final part of the Maritime Silk Road which has the ambition to reduce shipping times and make Chinese products more competitive in Europe. After passing the Suez Canal ships will be able to, instead of taking the long way through the Mediterranean Sea and the English Channel to the ports of Antwerp, Hamburg or Rotterdam, stop at the port of Piraeus in Greece (see figure 8). The port is a key access point of the BRI in its function as a inland gateway to Europe and the EU markets as this a much faster option than shipping containers to other ports in Northern Europe (Konings 2018, p. 2). A similar strategy was discussed for the Montenegrin port of Bar (Ralev 2019) but no concrete plans for this infrastructure project have evolved so far. The related construction of high speed railway sections from Belgrade to Budapest, in Greece and Northern Macedonia, as well as the upgrading of road infrastructure in the Western Balkan area will result in the opportunity to transport goods from Piraeus to Central and Western Europe at speeds of up to 200 km per hour (Casarini 2015, p. 4).

Figure 8: Southeast Europe's involvement into the BRI as the endpoint of the Maritime corridor (Source: Authors' elaboration visualized with a map from Google Maps).

3. The Selected Countries

3.1. Serbia

3.1.1. Country Overview

One of the countries that is being analyzed in this thesis is Serbia, formally known as the Republic of Serbia. Serbia is a landlocked country, bordering Hungary in the North, Croatia and Bosnia & Herzegovina and Montenegro in the West, Romania and Bulgaria in the East and North Macedonia and Kosovo in the South. Serbia has a population of 7 million (World Bank 2019) of which 1,4 million are estimated to live in the Serbian capital Belgrade (United Nations Statistics Division 2019). Located in Southeastern Europe, the country is one of the successor states of the Federal Republic of Yugoslavia (FYR) which dissolved in the early 1990s when Croatia, Slovenia, Macedonia and later Bosnia & Herzegovina declared their independence. During the breakup of Yugoslavia only Serbia and Montenegro remained under rule of the former Yugoslav president Slobodan Milošević. He was overthrown in 2000 during the NATO (North Atlantic Treaty Organization) bombings of the FYR in the Kosovo War that took place from 1999 to 2001. In 2006, Serbia and Montenegro peacefully dissolved their union and became to individual countries. Two years later the Kosovo declared its independence from Serbia and although lots of countries recognize the Kosovo as an independent state many other countries including Serbia, Russia and China do not recognize the Kosovo as a sovereign country. Since 2012 Serbia is a candidate country of the European Council and also opened accession negotiations with the European Union in 2014 (European Commission 2018, p.4). The latest report of the European Commission on the development of Serbia states that the country has a sufficient legal and institutional framework in place, a moderate level of public administration but only some level of preparation in the fields of fight against organized crime and corruption, judicial system and freedom of expression (European Commission 2018, p. 4).

3.1.2. Economic Situation

As of 2018, the middle income country had a GDP of EUR 45.1 billion or EUR 6,400 EUR per capita (World Bank 2019). The economy recorded a growth of 4.3 percent, the fastest growth rate in the last 10 years and is expected to grow relatively fast with a projected growth of 3.5 percent in 2019 (Martijn et al. 2019, p. 5-6). Nevertheless, Serbia is a relatively small and also

open economy what makes it relatively vulnerable to external factors like FDI inflows or developments in trade with its key trading partners in the EU (Martijn et al. 2019, p. 10). Like in many other Western Balkan countries there are large infrastructure gaps in Serbia, especially in the areas of transport and energy (Holzner and Schwarzhappel 2018, p. 6-9).

3.1.3. Serbia and the BRI

In recent decades China has been seen as an important partner and enjoys a high reputation among Serbians. This can be traced back to the fact that China always supported Serbia's position against the Kosovo, also during the NATO bombings of 1999, and still does not recognize the Kosovo as an independent nation (Beckmann-Dierkes et al. 2018, p. 41). In the light of the BRI Serbia and China signed a series of framework agreements on their economic cooperation in transport and infrastructure (Dimitrijević 2017, p. 69). Most importantly in 2015 they arrived at an agreement on the general framework of cooperation under the BRI, that can be considered to be one of the most developed ones among all BRI countries (Cosentino et al. 2018, p. 33). As previously explained Serbia is also a member of the 16+1 format through which China channels its interest in East and Southeast Europe (Dimitrijević 2017, p. 70). Serbia is one of the main beneficiaries of Chinese investment in the region and can be described as China's key partner among the 16+1 countries (Tonchev 2017). Consequently, Serbia receives substantial financial and technical assistance on a preferential basis (Barisitz and Radzyner 2017, p. 73). China's intention is to increase trade with Europe and according to the Konrad-Adenauer-Stiftung to get more influence in a country that might become a member of the EU in the future. This will result in economic benefits to China like an improved access to the European single market on the one hand but also potential political influence on decisions of the EU on the other hand (Beckmann-Dierkes et al. 43).

There are four main Chinese-financed BRI projects in Serbia:

- The Belgrade-Budapest high speed railway which is part of the rail transport system through North Macedonia, Serbia and Hungary that will create the Land-Sea Express Passage, connecting the port of Piraeus with the rest of Europe. First endorsed in 2013, China, Hungary and Serbia signed a MoU on cooperation in the project one year later. The total length of the high speed railway amounts to 370 km and a total cost of EUR 1.5 billion while the Serbian stretch alone accounts for 184 km and a cost of EUR 800 million (Barisitz and Radzyner 2017b, p.78). The financing institution for this project, like for most other projects in the Southeastern European region, is the

Chinese state-owned Export-Import Bank of China which provides 85% of the cost in form of loans. In a bidding process that did not comply with EU rules (Barisitz and Radzyner 2017b, p.72) the construction of the project was tendered and in the end the China Communications Construction Company (CCCC) was awarded the project. Originally construction was supposed to start in November 2014 and finished in mid-2017 (Barisitz and Radzyner 2017b, p.78) but today the railway is still under construction.

- The Pupin Bridge, named after the Serbian scientist Mihajlo Pupin, crosses the Danube river in Belgrade and is a another BRI-related project. It is considered to be one of the first large infrastructure projects within the 16+1 partnership (Orăștean et al. 2018, p. 309) and also “the first infrastructure project financed and constructed by China in Europe” (Pavličević 2014, p.10). Construction of the bridge was executed by the Chinese state-owned China Road and Bridge Corporation (CRBC), a subsidiary of the above mentioned CCCC, and opened as planned in December 2014 after three years of construction (Dimitrijević 2017, p. 71). The initial construction cost for the bridge was EUR 170 million, 85% of which was again financed with loans of the Export-Import Bank of China while the remaining 15% were provided by the Serbian government (Dimitrijević 2017, p. 71). In the end the costs amounted to EUR 250 million due to additional costs for expropriation and additional compensation payments for subcontractors (Dimitrijević 2017, p. 71).
- The Kostolac thermal power plant is the first BRI-related investment in Serbia that is not targeting the infrastructure but instead the energy sector of the country. Again, the project is financed by the Export-Import Bank of China which is providing a loan of EUR 550 million for the construction of a new thermal block of 350 MW and the expansion of a pit mine (Pavličević 2014, p.11). The loan is a preferential loan, guaranteed by the Serbian government with an annual interest of 2.5 percent and a 7 year grace period (Louvel 2018, p.3). Today, the project is still under construction by the China National Machinery and Equipment Import and Export Corporation (CMEC) and expected to be completed in 2019 (Louvel 2018, p.1).
- The modernization of the Serbian part of the Pan-European transport corridor XI leading to Montenegro. 85 percent of the estimated cost of EUR 900 million are loan financed by the Export-Import Bank of China (Barisitz and Radzyner 2017, p. 78).

The construction began in May 2015 and was expected to be completed in mid-2019 but that deadline was extended due to delays in construction works.

3.2. Montenegro

3.2.1. Country Overview

The second country that will be analyzed in this thesis is the Southeast European country of Montenegro. Located on the Adriatic Sea it borders Croatia in the West, Bosnia & Herzegovina in the Northwest, the Kosovo which is also claimed by Serbia in the Northeast and Albania in the Southeast. With 0.6 million inhabitants (World Bank 2018) Montenegro's population is more than ten times smaller than Serbia's. A third of the Montenegrin population lives in the countries' capital Podgorica (United Nations Statistics Division 2019) close to the Albanian border. As previously mentioned, after the breaking-up of Yugoslavia Montenegro formed a state union with Serbia that was dissolved in June 2006. Since then Montenegro is an independent nation and opened accession negotiations with the EU six years after its independence, in June 2012 (European Commission 2018, p. 3). The Montenegrin preparations for joining the EU are on a similar level as in Serbia. Public administration and the judicial system are only moderately prepared, while the fight against corruption and organized crime as well as the freedom of expression show a small level of preparation (European Commission 2018, p. 4-5).

3.2.2. Economic Situation

According to the IMF Montenegro is a "small, open euroized economy with high public debt and significant dependence on tourism and external financing." (Petri et al. 2018, p.4). In 2016, Montenegro had a GDP of EUR 3.8 billion (thirteen times smaller than Serbia's GDP) and a GDP per capita of EUR 6,200 (World Bank 2018). Economic growth is limited by a comparatively restricted labor market, high unemployment rate of 15.0% (Statistical Office of Montenegro 2019) and low productivity (Petri et al. 2018, p.4). Montenegro has no independent currency as it unilaterally decided to use the Euro as a currency (Petri et al. 2018, p.4). Like in Serbia, Montenegro has large infrastructure gaps in the areas of energy and especially transport with no single motorway in the whole country in 2015 (Holzner and Schwarzhappel 2018, p. 6).

3.2.3. Montenegro and the BRI

There is one big BRI-related construction project in Montenegro that will be heavily analyzed in this thesis as it has strong implications on the small countries' financial structure and could also have effects on the countries' external financing-dependent economy.

- The construction of the Bar-Boljare Highway is part of the Pan-European transport corridor XI from Bari via the Adriatic Sea to the Montenegrin port of Bar and Serbia to Romania (Barisitz and Radzyner 2017, p.78). The highway, constructed by the Chinese state-owned CRBC, is constructed in three phases and has a total length of 166 kilometers. The first phase from Podgorica to the mountainous and economically underdeveloped northern regions is expected to be completed in 2019 (Lindquist et al. 2018, p. 3) while the second and third phases are still in the design phase (European Commission 2018, p. 75). The total cost of this highway and another highway that is planned to be constructed at the Adriatic coast are expected to amount to more than EUR 2.8 billion, equal to 72 percent of the Montenegrin GDP in 2017 (Lindquist et al. 2018, p. 3). The cost of the 41 kilometer-long first phase of the Bar-Boljare highway that will be thoroughly analyzed in this thesis is estimated at about EUR 800 million, 85 percent of which are loan financed by the Export-Import Bank of China with long maturities and a very favorable interest rate of 2 percent while the Montenegrin government is providing the remaining 15 percent (Government of Montenegro 2014). The Montenegrin government states that there is a need to build the highway to boost trade and tourism and improve connectivity as well as road safety and national security (Government of Montenegro 2014).

4. Economic Effects on the Selected Countries

4.1. Effects on Economic Growth and Employment

On a global scale most BRI economies will profit from increased growth and lower unemployment rates. Ruta et al. (2019) suggest that the BRI could lift 7.6 million people out of extreme poverty and three times as much from moderate poverty. But at the same time the large costs for infrastructure projects can also lead to welfare losses (Ruta et al. 2019, p. 9). Although infrastructure building is inherently risky (Ruta et al. 2019, p. 9) most of the BRI projects are constructed by Chinese firms what leaves the construction risk to the Chinese parties involved (Cosentino et al. 2018, p.17). This is one of the factors why many countries use the opportunity to upgrade their infrastructure through the BRI. But although the positive growth and employment effects of infrastructure are undeniable, the construction of most BRI projects in Montenegro and Serbia by Chinese companies might only have limited spillover effects on the local economies. The behavior of the Chinese investors and construction companies already caused irritation and protest by the local population (Barisitz and Radzyner 2017a). In the following sections the author will examine the initiatives' effects on the two Balkan economies and try to answer the question whether the BRI can help to stimulate growth in the region and contribute to overcome its peripheral position in Europe. A focus will be laid on the examination of short- and medium-term effects since the long-term effects are still subject to debates and difficult to measure exactly. In the end the BRI-related gains will depend on the productivity increases of the BRI projects as such (Hurley et al. 2018, p. 2) and also on the success on the initiative as a whole.

4.1.1. Effects on Employment

In recent years infrastructure investment has become an increasingly used fiscal policy tool. It plays an important role in stimulating growth during a financial crisis or recession (OECD 2009). Low borrowing cost at international financial markets resulted in governments increasing their infrastructure investments to reduce potential output gaps (IMF 2014). But although many national governments use infrastructure investment to bolster economic conditions there are debates whether this strategy is an effective fiscal tool. Government investment can create jobs and increase future growth potential. In the short term increased

infrastructure can stimulate demand while in the long term long term productivity will increase (Stupak 2017). Since infrastructure investments usually triggers increases in economic output, they also affect employment. Confirming this statement, Buchheim and Watzinger (2017) explain that infrastructure spending results in modest reductions of local unemployment rates (Buchheim and Watzinger 2017, p. 3). But not all infrastructure spending is the same; Stupak (2017) adds that there is a difference in impact on employment between deficit-neutral and deficit-financed investments: Deficit-neutral investments have less impact on employment since the resources spent are deducted from other parts of the government's budget that might also have had an impact on the countries employment. Whereas deficit-financed investments have, although increasing government debt, additional effects on the country's employment, adding to existing government measures (Stupak 2017, p. 2).

Recalling that all investments in the analyzed countries are deficit-financed, this would mean that, ignoring the effects on government debt for the moment, the employment effects for Montenegro and Serbia should be substantial. And in theory this is supported by Chinese authorities supporting "localized operation and management" (NDRC 2015) and welcoming localized operation to "boost the local economy [and] increase local employment" (NDRC 2015). But the reality differs. Since most of financing, management and construction is usually in the hands of and carried out by Chinese firms and Chinese workers using Chinese equipment the immediate effects on employment are not significant (Barisitz and Radzyner 2017, p. 10). Looking at a specific BRI project, the previously mentioned Pupin bridge, named after the Serbian scientist Mihajlo Pupin, it appears that the impact on local employment is rather small, at least in the short run. In theory local Serbian labor would most likely profit from labor-intensive infrastructure projects (Barisitz and Radzyner 2017). But in reality the bridge was constructed by the Chinese state-owned China Road and Bridge Company (CRBC) which mostly relied on Chinese workers that were already previously involved in other overseas projects of the CRBC (Hollinshead 2015). Less than half of the workforce was Serbian, which were also not involved in the immediate construction process of the bridge and restricted to the construction of an approach road (Hollinshead 2015). Similar reports were published on the BRI project in Montenegro: the Bar-Boljare highway: As of December 2017 only 1,162 of the 3,048 were Montenegrin nationals, while the overwhelming majority of workers consisted of Chinese workers (Nurkovic 2017, p. 4). According to reports the 200 Chinese workers involved in the construction of Pupin bridge lived on a remote site outside Belgrade in dubious living conditions and in contradiction to Serbian health and safety regulations (Barisitz and Radzyner 2017). As a result "the local economy did not benefit greatly in terms of employment or consumption [in the short run]" (Barisitz and Radzyner 2017). Okun's Law which suggests

that an increase in economic growth leads to an increase in employment and the other way around (Bom and Ligthart 2015, pp. 889-916) does not fully apply here. Usually the additional amount of people to produce the required additional goods and services needed for the construction of the infrastructure increase the economic output and employment. This is not necessarily the case for the BRI projects in Montenegro and Serbia, since most workers are from China and a big part of the material is imported. This economic rule of thumb only applies to a limited extent for the projects analyzed. A report for the European Commission concludes that, besides sustaining weak governance the Chinese BRI-related lending and construction practices are “hardly conducive to boosting employment in host countries (Grieger 2018, p. 7).

Nevertheless, long term effects on employment of course may be more significant after the entire railway and road project from Piraeus to Budapest is completed. Faster productivity which is associated to infrastructure investments in the long term (Ball and Mankiw 2002, pp. 115-136) would eventually increase the long-term effects on employment even if the short-term effects might not be that significant. Similarly, in the long-term the Bar-Boljare highway could help to fight against the low productivity of the Montenegrin economy and boost employment, for example, through increased tourism caused by faster travel times. Recent research on the long-term effects of infrastructure spending on employment varies. However, an IMF study conducted in the United States suggests that an increase in infrastructure spending of 1 percentage point decreases the unemployment rate by 0.35 percent in the medium and long term (Abiad et al. 2015). This may be a helpful indication to get a glimpse on the possible prospects caused by the BRI's projects but while the short term developments of the projects are most likely slightly positive as discussed before, it is still too early to define any concrete developments in the Montenegrin and Serbian labor markets in the long term.

4.1.2. Effects on Economic Growth

According to Ruta et al. (2019) the improvement of connectivity generally makes sense from an economic point of view and also has spillover effects on neighboring countries (Ruta et al. 2019, p. 13). In the long term improved infrastructure such as new highways, bridges or railroads usually results in an increase in a countries output as new infrastructure increases the productivity of firms and individuals (Stupak 2017, p. 9). An example for this is the Pupin bridge in Belgrade which reduced the time to cross the Danube river. The saved time and the saved resources can be used to generate more economic output through, for example, delivering goods more quickly or increase leisure time. Since productivity is a the most

important determinant of an economy's long-term growth (Stupak 2017, p. 9) the productivity increase caused by the BRI has the potential to result in significant long-term effects. A study by Bom and Lighthart (2015) suggests that a 1 percent increase in public infrastructure would result in an increase in private-sector economic output of 0.083 percent in the short term and of 0.122 percent in the short term. Since the study was conducted for infrastructure projects in the USA it is not possible to directly transfer these results to Montenegro and Serbia but usually infrastructure in less developed countries have bigger effects on their GDP's than in already developed countries with high levels of existing infrastructure (Gurara et al. 2017, p. 3). Also, it is important to clarify that these results were calculated only for the private sector alone and results for the country's total economic output are most likely significantly bigger than the numbers given here. As for the impact on the country's' employment deficit-financed public investment into infrastructure is expected to stimulate economic output in the short and long term (Stupak 2017, p. 10). At least in theory the government is expected to purchase goods and services from local suppliers, increasing their income which leads to a so-called multiplier effect (Batini et al. 2014). For example, the suppliers or the supplier's employees that receive additional money through the infrastructure spending of the government can use this additional income to buy other goods and services of other companies, multiplying the effects on the economic output.

Looking at a specific BRI project, the Bar-Boljare highway, the International Monetary Fund (IMF) confirms that there are positive economic effects on the local economy. Already during the construction process demand in goods and services will increase due to the just explained multiplier effect on the Montenegrin economy (Lindquist et al. 2017, p. 4). Since Montenegro's economy has relatively rigid labor markets, low openness to trade and a high government expenditure the multiplier effect on the domestic economy would usually be relatively high compared to other small countries (Scott et al. 2016, p. 4). However, according to the Montenegrin government the contract allows the Chinese construction company to spend 70 percent of the investment sum on imports. The minimum amount of the construction cost that is to be spent to buy domestic goods and services amounts to 30 percent of the construction cost (Government of Montenegro 2014). As a result CBRC spends most of its budget on Chinese materials which is exempt from VAT or customs duties in both, Serbia and Montenegro (Grieger 2018, p. 7). In addition to that, of the expected 4,000 construction workers that will be engaged in the project during peak seasons (Government of Montenegro 2014) most are brought into the country by the Chinese construction company, live very isolated on the construction side and therefore only create very limited demand spillovers for the local economy (Barisitz and Radzyner 2017b, p. 73). As a result, Lindquist et al., on the

one hand, assume that the multiplier effect will only amount to 0.18. On the other hand, Montenegrin authorities believe that the multiplier on the local economy still can be higher than that and estimate a multiplier of more than 0.3 (Lindquist et al. 2017, p. 6). Using the assumptions of Lindquist et al. and the IMF the construction of the highway would have a relatively small effect on real GDP growth in the short-term (see figure 9) compared to the high investment volume caused by the large role of imports and foreign labor in the construction process.

And also the projections for the long and medium term are not only bright: Montenegro has a very low ranking in the public investment efficiency index (Dabla-Norris et al. 2010) what comes to light again in the Bar-Boljare highway project. According to a feasibility study cited by the IMF the economic return of the whole Bar-Boljare highway project only amounts to 6 percent while the normal benchmark for such a project would be a rate of return of 12 percent (Lindquist et al. 2017, p. 7). This low rate of return can be mostly traced back to the high cost per kilometer caused by the difficult terrain and the fact that traffic is likely to stay relatively low until the whole highway including the Serbian part from Boljare to Belgrade is finished. Construction for the Serbian part of the highway started in 2018 and would together with the construction of the two other Montenegrin parts of the highway which are still in the design phase increase the economic return and the economic outlook for both countries in the medium-term (Lindquist et al. 2017, p. 8). However, effects in the medium-term are expected to be stronger than in the short term. Positive supply effects caused by the improved infrastructure can range from an increase in output of around 0.4 percent in the first year of project completion to up to 1.5 percent five years later (World Economic Outlook 2014). Looking back at the Bar-Boljare highway project which is still under construction these supply effects on the economy's productivity have not yet begun and will also be affected by other local economic circumstances (Lindquist et al. 2017, p. 6). Due to low traffic expectations the effects in the medium term are expected to be relatively low but in the medium term there will be some spillovers (see figure 9). Petri et al. (2018) expects Montenegro's GDP in 2023 to be around 3 percent points higher than of the 2014 GDP with the construction of the first phase of the highway (Petri et al. 2018, p. 10).

Highway and Fiscal Adjustment: Contribution to Real GDP (percent of real GDP)

Figure 9: The IMF's estimates and projections on the Bar Bolare highways' contribution to real GDP (Source: Petri et al. 2018).

However in the long run additional growth is expected to decline as a result of higher depreciation and debt-related costs, leading to a GDP in the very long run that would be as high with the construction of the highway as it would be without (Lindquist et al. 2017). Summarizing, the BRI core projects, like every other one in Montenegro and Serbia, are all deficit-financed investments that most likely have an impact especially in the short- and also in the medium-term. In the long term due to crowding out the gains would be larger if the investment would have been deficit neutral (Stupak 2017, p. 16). Figure 10 shows the expected development of Montenegro's GDP with and without the construction on the highway. Although there will be some spillovers in the short- and medium-term as shown in figure 9 the long-term growth of the country's' GDP will not be significantly with real GDP growth being lower with the construction of the highway than without it in 2024 (see figure 10).

Figure 10: The IMF's estimations on real GDP growth with and without the highway on basis of data from the Montenegrin Statistical Bureau and the IMF's projections (Source: Lindquist et al. 2017).

In addition to the estimations of the IMF the Directorate-General for Neighbourhood and Enlargement Negotiations explained to the author upon request that currently under the Western Balkans Investment Framework (WBIF) a consultancy is preparing a feasibility and cost-benefit analysis for the Bar-Boljare highway fully financed by the European Bank for Development and Reconstruction (EBDR). In the electronic communication with the author the Directorate-General further explained that first results are expected this autumn while the complete study will be completed by spring/summer 2020 and handed over to the Montenegrin Ministry of Transport and Maritime Affairs. This study will most likely add important and insightful information on the economic benefits of the Montenegrin BRI project but unfortunately will be, as just explained, only be published after the completion date of this thesis. Another cost-benefit analysis, that was handed over to the Montenegrin Ministry of Transport and Maritime Affairs in 2012 (European External Action Service 2019, p. 2) is not publicly accessible and although EU-financed NGOs pressed the Montenegrin government to make it available to members of the Montenegrin parliament no such action has taken place limiting the information that is available on the costs, benefits and risks of the Bar-Boljare highway.

4.2. Effects on Trade

In principle the upgrading of infrastructure and investments in transports are expected to have positive consequences on the participating country and the global economy. As the BRI spans over several economic corridor's countries can not only profit from better transportation networks in the domestic market but also in potential transit countries for the ex- or import of goods and services to third countries. Investments have the potential to reduce transport time and cost, consequently leading to an increase in trade and foreign direct investment (FDI). The accelerating trade could lead to an increase in GDP and household income and lead to aggregate gains for the economy. Nevertheless, not all individual countries will necessarily profit from the investments: expensive infrastructure projects may fail or the investment may not pay off when considering the project costs in comparison to the potential gains in trade. In the following section the possible overall trade effects of the BRI on Montenegro and Serbia will be analyzed and reflected. Although the BRI was initiated by China not only the Serbia-China and the Montenegro-China trade times and costs will be reduced but also the trade with other BRI or non-BRI countries is expected to be affected by the trade gains. A study of the World Bank estimates that countries in the economic corridors can on average expect reductions in shipping time of 4 percent with other countries from other BRI economic corridors and 3.2 percent on average with third countries (Ruta et al. 2019).

4.2.1. Methodology

To analyze the potential reduction in trade time the author relied on data from the Belt And Road Initiative Trade Costs Database of the World Bank. It was created for a study that analyzed the impact of new BRI infrastructure on trade on a global scale. The study includes 1,000 cities in 191 countries and therefore manages to provide a comprehensive picture of the global trade effects of the BRI. In the study a focus is laid on the network effects of the BRI transport corridors and BRI projects. Shipping times were estimated to perform a network analysis between the selected cities in pairs before and after the implementation to calculate the impact on trade time. The authors of the database then transformed the results of the trade time analysis to trade costs, using the findings of Hummels and Schaur (2013) which provide data for shipment dates and cost of trade (de Soyres et al. 2018). The author will use the Belt and Road Initiative Trade Costs Database of the World Bank as a basis for his analysis in this section about trade time effects and in the following section which discusses the trade cost effects. The methodology that is used by the author to calculate the reduction in trade time and costs is the computation of the average reduction for each country from the existing data.

Unfortunately, the database does not individually examine the countries of Montenegro and Serbia which are analyzed in this thesis. Upon request, Francois de Soyres, one of the creators of the database, explained that these countries are only included in the data set “Rest of Europe” to be consistent with the GTAP composition.² Although, the data set “Rest of Europe” also includes geographically and structural similar countries like Bosnia & Herzegovina or North Macedonia unfortunately it also includes many other countries like Gibraltar, Andorra, the Faroe Islands, the Holy See, Monaco, etc. that will be affected in a significantly different way than Montenegro or Serbia. As a result, in this analysis the country data for Albania, a geographically and structurally similar neighboring country to Montenegro and Serbia that is also involved in some BRI projects, will be used to analyze the trade effects. Of course, the effects on Albania will not be exactly like the effects on its neighbor countries but still allows to make some assumptions on possible similar effects on trade.

As stated by de Soyres et al. (2018), the Belt And Road Initiative Trade Costs Database of the World Bank provides data for two different scenarios (i) a lower bound scenario in which exporters don't change their mode of transportation and (ii) an upper bound scenario in which exporters change their mode of transportation to take advantage from new opportunities that arise through BRI projects. The authors explain that the lower bound scenario is a more conservative estimate that assumes that the mode of transportation does not change because of potential cost increases that might occur when moving to a faster mode of transportation. For example, a change from transport via sea to transport via rail might significantly increase shipping times but also shipping costs. This scenario can be interpreted as a “minimum gain” of using new and upgraded BRI transport infrastructure. The upper bound scenario assumes that transporters change to the fastest mode of transportation after the implementation of the BRI, even if that might have consequences like an increase of shipping costs. In most cases this will result in a change from maritime to rail transport. A problem with this scenario is that the algorithm might switch to already existing pre-BRI rail links independently whether the project is a BRI project or not. To avoid these cases which would have falsified the analysis the mode of transportation in this scenario will not be changed if there already is a faster rail link between two cities that is not part of the BRI (de Soyres et al. 2018). To account for the upgraded infrastructure, it is assumed that the BRI modernization projects lead to an increased speed. The upgraded rail speed is assumed to increase from 50 kph to 75 kph through the construction of high-speed train networks (Baniya et al. 2019, p. 6). Upgraded ports are assumed to handle merchandise faster than before using the minimum times in the respective region which were produced by Slack et al. (2018).

² GTAP composition: <https://www.gtap.agecon.purdue.edu/databases/regions.aspx?Version=10.131>

4.2.2. Trade Time

Lengthy shipping times, inventory holding costs and depreciation impose significant costs for firms engaged in trade. In addition to that, big time differences between ordering and delivery and fast changing consumer preferences make it difficult to quickly react to satisfy the customer's needs, resulting in profitability losses (Hummels and Schaur 2012, p. 1-2). A reduction in shipping time caused by the BRI has the potential to strongly reduce trade costs for all participating countries (Ruta et al. 2019, p. 38) through an increase in flexibility and a reduction of shipping times in general, either through switching to a faster mode of transportation or by using faster rail networks or modernized ports. Looking at the BRI as a whole, average shipping times for all city-pairs of the 1,000 cities that were part of the global database was 22.9 days before the BRI. In the lower bound scenario this number declines by 0.3 days (7 hours) to 22.6 days, in the upper bound scenario by 0.6 days (15 hours). These numbers are a global average and the numbers between the individual economies vary strongly since some economies are affected more by the BRI than others (Soyres et al. 2018, p. 14-15).

As can be observed in figure 11 differences between the lower and the upper bound scenario are enormous for some countries and regions but less for others. The average change in trade is highest with Turkey, transportation times are expected to decrease by 8.2 percent in the lower bound scenario or up to 9.0 percent in the upper bound scenario. Next are many Southeast Asian countries like Cambodia, Vietnam or Malaysia with time decreases of up to 7.8 percent. For these countries transport via rail to or from Southeast Europe is economically not justifiable. As a result, transports will in most cases not change from maritime to rail transport what explains the consistency of lower and upper bound scenarios for Southeast and East Asian countries. The trade with central Asian countries especially Kazakhstan will also be substantially affected by the BRI. Trade with the country is expected to increase, depending on the scenario by around 5 percent.

Noticeably, in the lower bound scenario the effects on trade with other European countries are nearly non-existent. The only European country that would have shorter trade times with Albania, and consequently assuming, also with Montenegro and Serbia, is Greece. The route between these countries is part of the maritime corridor to Europe from the port of Piraeus, transiting through the Balkans to Central Europe. Only if transporters to Central, Northern or Western Europe would change their mode of transportation they would be able to take advantage from trade time gains. But these gains are expected to be not anywhere as

significant as the ones of their Asian counterparts. The highest reduction in transportation time would occur for the trade to Switzerland with 1.6 percent and the Benelux countries which could profit from trade time gains of 1.1 to 1.5 percent (see figure 11).

Country	Lower Bound Scenario	Upper Bound Scenario
Turkey	10,47%	11,38%
Cambodia	7,82%	7,82%
Mauritius	7,11%	7,11%
Vietnam	5,40%	5,40%
Kazakhstan	4,66%	5,28%
Kenya	4,42%	4,54%
Malaysia	4,15%	4,15%
Hong Kong	3,61%	3,61%
Uganda	3,59%	3,59%
Taiwan (Province of China)	3,58%	3,58%
China	3,51%	3,51%
Korea (the Republic of)	3,25%	3,25%
Japan	3,23%	3,23%
Philippines (the)	3,20%	3,20%
Tanzania, United Republic of	2,98%	3,02%
Rwanda	2,28%	2,28%
Azerbaijan	2,01%	2,01%
Ethiopia	1,91%	1,91%
Kyrgyzstan	1,76%	5,10%
Pakistan	1,76%	2,76%

Figure 11: The 20 highest reanking country in the lower bound-sorted (conservative) scenario of the BRI's effects on trade time at the example of Albania (Source: Author's own analysis of data retrieved from the Belt and Road Initiative Trade Costs Database of the World Bank; de Soyres et al. 2018).

4.2.3. Trade Cost

Many different areas in international trade chains factor into the cost of trade. Tariff barriers and non-tariff barriers to trade can have restrictive effects on the trade of products and services. Also transport time can be a significant trade barrier (Soyres et al. 2018, p. 19).

According to a trade policy paper of the Organization for Trade and Economic Cooperation (OECD) transport infrastructure and logistics are one of the most important factors. Although it is very costly to build transport infrastructure it has the most significant impact on trade cost. A delay in transportation time can have serious implications on cost but also on the trade volume. Thus it is crucial, to either reduce transport time through the improvement of transport infrastructure or the facilitation of trade for example through easing customs clearing processes at borders (Moïsé and Le Bris 2013, p. 4). This fact was also taken into account by the Chinese government. As previously discussed, new or upgraded infrastructure can help significantly to decrease the transportation time between countries. But one also has to take into account that infrastructure alone is not the only factor that affects trade time. That is why the Chinese White Paper on the BRI intensively explains that it is also crucial to “promote trade facilitation” (NDRC 2015).

Using the same methodology as described for the calculation of the change in trade time one can estimate the potential change in trade costs caused by the BRI. The authors of the study assumed that the logistics costs and tariffs are not affected by the BRI and focused on the element of time as a basis to calculate the change in costs (Soyres et al. 2018). But there are, as described in the last paragraph, efforts by the Chinese side to facilitate trade and reduce tariffs, like for example with Serbia. Thus, by not only accounting for the saved cost through faster transportation time but also including other factors it is possible that the cost reductions could be even higher than the data of the Belt and Road Initiative Trade Costs Database of the World Bank indicates. Baniya et al. (2019) assume that tariff rates of BRI countries will be cut in half (Baniya et al. 2019). As a result, the analysis of the database shows a decrease of cost of trade in the lower and upper bound scenario that is lower than the reduction of trade time. On a global perspective, the implementation of all BRI projects covered in the World Bank study would lead to a decrease of average trade costs between BRI economies and other countries by 2.8 percent and 3.5 between BRI economies. As for the reduction in trade time there is a huge discrepancy between the countries involved. Especially East, and South Asian countries will profit the most but also countries along the China-Central Asia-West Asia economic corridor where the cost of trade could decline by up to 10 percent. (Ruta et al. 2019)

Bearing in mind that all numbers are calculated for Montenegro's neighboring country Albania and not specifically for Montenegro and Serbia, the results from figure 12 show that through the strong influence of trade time on trade costs the percentual effects of the BRI on trade cost are very similar to the effects on trade time. For trade to nearly all countries there is no significant difference in the ranking between countries and only slight differences in the

percentual change (see figure 12). Again, there are the same discrepancies between lower and upper bound scenarios. The country with which bilateral trade could profit the most from reduced trade cost is again Turkey with cost reductions of more than 8 percent for both the lower and upper bound scenario (see figure 12). Closely behind are the Southeast Asian countries of Cambodia and Mauritius and Vietnam (see figure 12) who will experience reduced trade costs through the modernization and building of port infrastructure along the maritime route of the BRI.

Country	Lower Bound Scenario	Upper Bound Scenario
Turkey	8%	9%
Cambodia	8%	8%
Mauritius	7%	7%
Vietnam	5%	5%
Kenya	4%	5%
Kazakhstan	4%	5%
Malaysia	4%	4%
Hong Kong	4%	4%
Uganda	4%	4%
Taiwan (Province of China)	3%	3%
China	3%	3%
Philippines (the)	3%	3%
Japan	3%	3%
Korea (the Republic of)	3%	3%
Tanzania, United Republic of	3%	3%
Rwanda	2%	2%
Azerbaijan	2%	2%
Ethiopia	2%	2%
Kyrgyzstan	2%	1%
Pakistan	2%	3%

Figure 12: The 20 highest reanking country in the lower bound-sorted (conservative) scenario of the BRI's effects on trade cost at the example of Albania (Source: Author's own analysis of data retrieved from the Belt and Road Initiative Trade Costs Database of the World Bank; de Soyres et al. 2018).

Using a regression model of value-added flows Boffa (2018) calculated that a reduction of trade costs by 1 percent could result in an increase in trade between BRI economies by 1.3 percent. For domestic value-added goods that return home, the most beneficial value chain to the involved economies, the cost reduction could even lead to an increase in bilateral trade of 1.7 percent (Boffa 2018). This proves that a reduction in trade cost caused by the reduction of trade time through BRI infrastructure projects can lead to substantial increases in trade between BRI economies. Countries in the heart of many BRI corridors like Uzbekistan, Myanmar or Iran will be able to increase their trade volume the most with increasing exports of more than 7 percent (Baniya et al. 2019, p. 21). World trade is expected to increase by 1.7 to 6.2 percent through the initiatives' reductions in trade time and trade costs (Ruta 2019, p. 14). Montenegro and Serbia, although playing a key role in the BRI's maritime gateway to Europe will not benefit as much as the core countries of the initiative but will be able to take advantage from the BRI's network effects.

4.3. Effects on Financial Stability

4.3.1. Cost and Financing of BRI Projects

Most BRI projects are financed by Chinese banks and international financial institutions that were created to finance the initiative. Two of the Chinese "BRI policy banks", the China Development Bank (CDB) and the Export-Import Bank of China (China Exim Bank) with a starting capital of more than USD 60 billion (Djankov and Miner, 2016, p. 9) and the four state-owned commercial banks Bank of China (BOC), China Construction Bank (CCB), the Industrial and Commercial Bank of China (ICBC) and the Agricultural Bank of China (ABC) engage in financing of BRI projects. Next to these already existing banks other newly established institutions that are entitled to provide funding for BRI projects are:

- The Silk and Road Fund (SRF), founded in 2014 by China's government with a starting capital of USD 40 billion provided by the State Administration of Foreign Exchange, the Export-Import Bank of China, the China Development Bank and the Chinese Investment Cooperation. The fund mainly acquires stakes in ventures along the BRI economic corridors and invested USD 6 billion as of early 2017 (Barisitz and Radzyner 2017a, p. 10)
- The Asian Infrastructure Investment Bank (AIIB), also founded in 2014 as a multilateral institution with 52 members (see figure 13). Shareholders include many countries along the BRI's economic corridors and also some European countries like, for

example, Germany (Grieger 2016, p. 6). With a capital of around USD 100 billion dollars the AIIB has challenged the outstanding position of the Japanese-led Asian Development Bank and the US-dominated World Bank (Grieger 2016, p. 6). By 2017 the AIIB invested USD 2.6 billion in BRI-related projects (Djankov and Miner, 2016, p. 9).

- The New Development Bank (NDB), established in 2014 by Brazil, Russia, India, China and South Africa with a starting capital of also USD 100 billion. Of that capital around USD 10 billion is designated to be spent on BRI projects (Barisitz and Radzyner 2017a, p. 10)

Card-carrying members

Figure 13: Member countries of the Asian Development Bank as of 2015 (Source: South China Morning Post 2015).

When analyzing the amount of money, these banks and organizations have actually provided for BRI projects it can be observed that the majority of funds is granted by the four commercial banks and the CDB. The banks and organizations that were created to fund the BRI have in comparison only provided a very small amount of funds as can be observed in figure 14.

Figure 14: BRI-related outstanding loans and equity investment by the Chinese banking sector in USD billion at the end of 2016 (Source: Cosentino et al. 2017).

In Southeast Europe BRI projects are usually financed with loans from the state-owned Export-Import Bank of China and the local government. The Export-Import Bank of China covers 85% of the capital to very favorable conditions with long maturities, and a fixed interest rate of around 2 percent (Barisitz and Radzyner 2017b). An example is the construction of the priority part of the Bar-Boljare highway that will connect the port of Bar on the Adriatic coast of Montenegro with Boljare at the Serbian border. In the end of October 2014, Montenegrin Finance Minister Žugić announced the loan agreement of the project that is expected to cost USD 1.1 billion. He further stated that the China EXIM bank agreed to provide 85 percent of the expected total cost of USD 935 million while the Montenegrin government will provide the remaining 15 percent (EUR 165 million) (Government of Montenegro 2014). These loan conditions apply for all projects analyzed in this thesis.

4.3.2. Impact on Government Debt

Research done by Hurley et al. (2019) suggests that there will be no systematic debt problem in the BRI's focus countries. The reason for that is that although absolute BRI financing numbers may let one to believe that the investment volume is extremely large, when compared to the aggregate size of the countries' economies the infrastructure investment levels seem rather normal (Hurley et al. 2018, p. 5). But not every country is involved in the BRI to the same extent as the BRI average and size of the economies varies significantly. As a result, although aggregate numbers for all BRI countries seem to be normal and non-alarming, some

countries, especially small and poor ones, are confronted by seriously higher credit risks of debt default by BRI projects (Hurley et al. 2018, p. 5). A study conducted by the Center for Global Development identified that 23 BRI countries that are at risk of debt distress as stated in standard measures of debt sustainability. Recent research indicates that the threshold for debt sustainability usually lays at debt levels of more than 50-60 percent of a country's GDP when debt levels are rising (Chudik et al. 2015). This threshold is supported by the EU's debt criterion defined in the Stability and Growth Pact which states that a state "is non-compliant with the debt requirement if its general government debt is greater than 60 percent of GDP" (European Commission's Directorate-General for Economic and Financial Affairs, p. 46). Debt thresholds describe the point at which public debt is at a level that causes economic growth to stagnate or even decrease resulting in debt default or debt treatment (Hurley et al. 2018, p. 11). The threshold at which these significant consequences might come into effect of course varies from country to country but in this thesis the analysis of Montenegro's and Serbia's will be based on statistically significant thresholds mentioned previously.

Before the international financial crisis of 2007/2008, the countries that are being analyzed managed to reduce their government debt to a level of only slightly more than 30 percent (see figure 15). Especially Serbia improved drastically managing to reduce government debt by 50 percent in only three years from 2004 to 2007. As figure 15 shows both countries had an annual rise in debt levels starting after and caused by the international financial crisis (Petri et al. 2018, p.13) and lasting until 2015. During these years' debt levels in the two countries behaved very similar with differences in debt levels of less than 5 percentage points for all years in this timespan with the exception of 2009 when the debt of Montenegro was nearly 10 percentage points larger than that of Serbia. Due to these rising government debts, both Montenegro and Serbia, surpassed the threshold of around 60 percent in 2014, decreasing the debt sustainability of the two countries. In 2016, both countries managed to slightly improve their general government gross debt in percent of GDP and still showed similar debt levels. But taking a look at the developments of debt levels after 2016 shows considerable differences. While Serbia managed to further decrease its general government debt, Montenegro's debt started to rise again. The IMF's World Economic Outlook from April 2019 projects that Montenegro's government debt will continue to rise to nearly 80 percent by 2020, while Serbia's government debt is expected to continue its annual reduction. This would result in Montenegro having debt levels more than 20 percentage points higher than the ones of Serbia in the next years and a difference of nearly 30 percentage points in 2020 (IMF 2019).

Figure 15: The general government gross debt of Montenegro and Serbia in percent of GDP (Source: IMF 2019).

The main reason for the strong growth of Montenegro's debt is the financing of the first phase of the Bar-Boljare highway (Hurley et al. 2019, p. 17-18). Other smaller reasons for rising debt might also be a costly mothers benefit scheme as well as public-sector wage increases (Petri et. al 2018, p. 13), but overall "public debt growth is driven to a large extent by [...] the highway" (European Commission 2018, p.42). Estimated costs rose from around EUR 800 to more than EUR 900 million or nearly a quarter of Montenegro's GDP in 2017 for the first phase of the highway alone (Petri et. al 2018, p. 4). The cost increase was mainly caused by the fact that the currency risks of the USD-denominated loans were not hedged while the USD appreciated substantially (Petri et. al 2018, p. 4). The IMF comes to the conclusion that most of the increase in general government debt in the next years will be caused by the financing of the highway and debt would have been nearly 30 percent lower if the highway would have been never constructed (Lindquist et al. 2017). As shown in figure 15 Montenegro's government debt was already declining in 2016 and 2017. This declining path would have continued and the Montenegrin fiscal responsibility law targets would have been achieved if Montenegro would have decided not to build the highway (Lindquist et al. 2017). Furthermore the IMF states in a report on Montenegro that covers the impact of the highway project on debt that there was no

need to launch such an investment and that the country's "debt without the highway would have been sustainable" (Lindquist et al. 2017).

Assuming that Montenegro will not build the second and third phase of the highway debt levels will start to decline and in the medium-term achieve a sustainable level (Lindquist et al. 2017). Given the high costs for the two phases of around EUR 1.2 billion Montenegro can "not afford to complete the remaining sections of the highway in the foreseeable future" (Lindquist et al. 2017). According to a IMF country Report on Montenegro from 2018 financing of the next phases of the highway would pose a huge risk for the country's' debt sustainability (Petri et al. 2018). The financing of phase two and three of the Bar-Boljare highway should only be realized with financial instruments like grants or concessional funds. Otherwise the unsustainable levels of debt could result in a debt default (Hurley et al. 2019). In addition to that, the expected economic return for the highway is very low, and spending on more growth-enhancing investments with a higher return and fewer debt concerns would have substantially higher benefits for the Montenegrin economy than the construction of the Bar-Boljare highway (European Commission 2018, p.42). Furthermore the European Commission urges Montenegro to continue its fiscal consolidation efforts as this would be essential to stabilize public debt and move towards a debt level that complies with the requirements for the country's' accession to the EU (European Commission 2018, p.70).

Gross Nominal Public Debt

(in percent of GDP)

Figure 16: The IMF's estimations on real GDP growth with and without the highway on basis of data from the Montenegrin Statistical Bureau and the IMF's projections (Source: Lindquist et al. 2017).

4.3.3. Risk of a “Debt Trap”

Several reports have signaled that the effects on government debt caused by the BRI are reaching an alarming level (Zhang 2018) (Kumar 2018) (Parker 2018). The debt sustainability of BRI countries could be endangered by high debt levels and the significant negative implications especially on developing economies connected to too much debt due to the easily accessible BRI funding (Grieger 2016, p. 7). Government borrowing should always be connected to sufficient economic growth and government income to service the debt and avoid fiscal consolidation on the backs of the country's citizens (Sturzenegger and Zettelmeyer 2006). Uncertainty whether a country with strongly growing debt is able to service its debt can significantly increase capital costs through higher risk premiums for lenders, resulting in debt levels growing even more (Nicolini, 2016). In the worst case an uncontrollably growing risk premium could eventually lead to a sovereign default with dramatic consequences for a country's economy and its citizens (Hurley et al. 2018, p. 3).

As explained earlier, some accuse China of using the BRI to pursue its geopolitical goals. In reality this might look like the acquisition of political influence or even strategic equity in the form of property like motorways, ports or railways through so-called “debt book diplomacy” or “debt-traps” (Parker 2018, p. 3). Rex Tillerson, former American Secretary of State described the Chinese economic tactics as “predatory loan practices, and corrupt deals that mire nations in debt and undercut their sovereignty, denying them their long-term, self-sustaining growth” (Tillerson 2018).

Parker (2018) has identified three phases that describe Chinese debt book diplomacy in BRI projects: First, there is the investment stage in which China invests heavily in a country's infrastructure through lucrative loans with long grace periods and low interest rates that especially appeal to countries that are economically weaker and consequently have less access to international financing and high levels of corruption. The second stage consists of the construction and the operation of the projects. Many BRI projects have yielded very low returns, often not enough to service the country's obligations to China. In the third and last stage China collects its debts. If the lending country is unable to service its financial obligations China then offers debt forgiveness if the lending country in return agrees to offer strategic equities like motorways, ports or railways or offers China political influence with the adoption of China-friendly political conditions (Parker 2018, p. 4, 8).

A case in point for that is the Magampura Mahinda Rajapaksa Port in the Sri Lankan coastal city of Hambantota (from now on referred to as “Hambantota port”). Amid human rights concerns international organizations like the IMF, the World Bank or the ADB did not lend money to the civil war-torn country to upgrade the port infrastructure of Sri Lanka in the late 2000s (Freymann 2018). Instead, China provided financing for Hambantota port and also oversaw the construction that was being done by Chinese state-owned companies. Through several additions to the initial project plan like an airport and a new economic zone costs for the port grew from USD 361 million to USD 1.9 billion (Freymann 2018). But despite these ambitious investments the port proved to be economically unviable and is yet to generate any profit (Freymann 2018). As a result of Sri Lankan debt distress, “opaque lending practices and questionable commercial viability” (Parker 2018, p. 3) the country owed more than USD 8 billion to China and Chinese-owned institutions in 2017 (Freymann 2018). China agreed with the Sri Lankan government on converting its debt holdings into an 85 percent stake of the port in a 99-year lease and was also granted tax concessions to continue to develop the port (Kumar 2018, p. 6). This makes Hambantota port a prime example of a debt trap caused by a project related to China’s BRI: the need to generate profit to pay off the initial debt resulted in a deadly cycle that eventually resulted in a debt-equity swap (Parker 2018, p. 10). According to the Chinese White Paper the BRI is in line with the Five Principles of Peaceful Coexistence, one of them being mutual respect for each other’s sovereignty (NDRC 2015). The debt book diplomacy and the related overtaking of equity in a foreign country could be seen as an indirect breach against this principle or as Kumar (2018) describes it: “a brand new form of neo-colonialism” (Kumar 2018, p. 6).

After learning about the example of Sri Lanka it makes sense to examine whether there are similar threats of debt defaults and equity swaps for Montenegrin and Serbian BRI projects. Starting with Montenegro, the growing debt distress of the country is reflected in worsening credit ratings. Although the Government of Montenegro interprets the latest B+ rating with a stable outlook by Standard & Poor’s (S&P) as a confirmation of the countries’ economy being on the right track (Government of Montenegro 2019) the trend of the last years proves different. In 2008, the credit rating agencies S&P and Moody’s both classified the Montenegrin credit rating as non-investment grade speculative³. After several years of growing government debt, today the two agencies classify Montenegro’s credit rating as highly speculative: S&P lowered the rating by three levels from BB+ in 2008 to B+ as of today. A downgrade from the “BB” to the “B” rating is given when an obligation becomes more vulnerable to nonpayment but the obligor still has the capacity to service his financial commitments (Standard & Poor’s

³ The credit rating company “Fitch” did not publish any credit risk ratings for Montenegro.

2019). Moody's lowered its credit rating for Montenegro in the same time frame by two levels from Ba2 to B1, meaning that risk for long-term obligations increased from a substantial credit risk with some speculative elements to a high credit risk with considerable speculatively (Moody's Investors Service 2019). The only positive development of Montenegro's credit ratings in the last decades is the decision of the two credit rating agencies to change the credit rating outlook to "stable" in the last two years or in Moody's case even to a "positive" outlook.

Figure 17: Montenegro's credit ratings from the three major credit rating agencies from 2008 to 2018 in comparison to the country's debt in % of GDP (Sources: Standard & Poors, Moody's, IMF).

Serbia on the other hand started worse off than Montenegro when it comes to its credit rating. In 2008, S&P and Fitch both rated the Serbian credit risk at BB-, two levels worse than S&P's credit rating for Montenegro in the same year⁴ (see figure 17). Due to the growing debt levels after the international financial crisis Serbia's debt levels slightly worsened until 2014 (see figure 18). But as explained earlier, Serbia managed to control its debt and debt has been shrinking since 2016 and is expected to continue to do so in the coming years (figure 15). As a result, since 2016 ratings of all three major credit rating agencies started to increase, reducing the risk premium Serbia has to pay when borrowing capital. In contradiction to 2008, today all agencies rate Serbia's credit rating higher than Montenegro's. Moody's ranks Serbia's credit risk at "Ba3", one level higher than Montenegro's and describes it as a financial

⁴ From 2008 to 2013 there are no credit ratings of the rating agency Moody's for Serbia available.

obligation with some speculative elements and substantial credit risk (Moody's Investors Service 2019). S&P and Fitch rank Serbia even better with a rating of "BB", two levels better than the S&P rating for Montenegro meaning it is "less vulnerable to nonpayment than other speculative issues" (Standard & Poor's 2019).

Figure 18: Serbia's credit ratings from the three major credit rating agencies from 2008 to 2018 in comparison to the country's debt in % of GDP (Sources: Standard & Poors, Moody's, Fitch, IMF).

For both countries there is a distinguishable correlation between government debt and the credit rating of the country which was just described in the previous paragraphs and can be easily comprehended by analyzing figure 17 and 20. Montenegro's credit rating is still worsening as a result of growing government debt while Serbia's credit ranking is getting better due to decreasing government debt in the last years. Two developments that will most likely continue in the future when analyzing the expected debt developments of the two countries in the previous chapters. Serbia appears to be on a stable path and should be able to avoid suffering from severe debt-related negative implications. In Montenegro the high government debt that was caused by the extremely high BRI-investment in relation to the country's GDP and the subsequently increasing capital costs leaves the country worse off in comparison to its Eastern neighbor. In addition to that, figure 19 allows one to observe that not only the total government debt of Montenegro is growing but especially the relative debt to China is increasing significantly.

Figure 19: The IMF's estimations on real GDP growth with and without the highway on basis of data from the Montenegrin Statistical Bureau and the IMF's projections (Source: Lindquist et al. 2017).

The IMF believes that the second and third parts of the highway should only go forward with highly concessional funds because non-concessional terms would likely result in debt default (Hurley et al. 2018, p. 18). There is the aggravating fact that, does not possess the capability of issuing monetary countermeasures as the euroization leaves the country with no independent monetary policy (Scott et al., p. 4). The loan contract of the BRI projects in Montenegro and Serbia state that in case of debt default-related litigation the lawsuits will fall under the jurisdictions of a Chinese court reducing the chance of a positive result for the two countries due to "the specificities of the Chinese judicial system" (Grieger 2018, p. 7). Dejan Milovac, deputy executive director of the EU-financed NGO MANS, even states that similar to Hambantota port in Sri Lanka, the bar-Boljare highway and its debt could lead to a vicious cycle of high government debt and a dependency on Chinese money with potential collateral claims by the People's Republic (Harenbrock 2019) The gains of BRI infrastructure projects are always tied to considerable risks. Already today around 25 percent of BRI corridor economies are challenged by relatively high debt levels with increasing vulnerability, especially in the medium-term (Ruta 2019, p. 9). Every BRI project must be considered carefully, should be consistent with national development policies and should be economically viable to reach its full potential

5. Summary and Conclusions

During the current political atmosphere in Europe with rising nationalism and the fact that for the first time in the EU's history a country plans to leave the union, Montenegro and Serbia still face lots of challenges before they will be able to become EU member states. Until then it is likely that they will continue to look for fast and, at least on the first look, uncomplicated and unproblematic financing methods. The low bureaucratic hurdles and the fast implementation of Chinese-backed infrastructure projects will continue to be a lucrative alternative to the funds provided by the EU. That these advantageous parameters are also caused by the bypassing of EU regulations, as well as national laws on tendering, procurement, safety or labor laws are partially circumvented. The 16+1 format could be a good way to coordinate these investment flows across European borders. But it also poses challenges to the cohesion of the EU as a whole through the growing influence of China through its financing activities and a wide range of other "soft power" activities in the East and Southeast European countries involved in the format.

Since most of the work on the construction sites is done by Chinese workers the immediate effects on local unemployment rates in Montenegro and Serbia will be relatively small. Additionally, many of the goods used to construct the projects are imported from China and exempt from local VAT, resulting in short-term economic spillovers that will be small as well. Nevertheless, the medium- and long-term effects caused by the BRI projects in the two countries will be more significant. The projects have the potential to increase productivity and stimulate economic growth. Functioning as a "gateway to Europe" the two countries and the Southeast European region as a whole could have the opportunity to leave its rather peripheral position in Europe behind and evolve to a transit hub for Asian trade to Europe and vice versa. Especially the projects in Serbia seem economically viable and will most likely play an important role in Serbia's future development. However, it is crucial that the projects are fully implemented since some of them rely on their interconnectivity to other infrastructure projects in neighboring countries. The high speed railway from Piraeus to Budapest is on a promising path to achieve this goal although there are still underdeveloped parts of the route, especially in North Macedonia. The picture looks different for Montenegro and its prestigious highway project. Some news outlets already describe the first phase of the project as a highway to nowhere. The low traffic expectations can only be overcome through the construction of the two other phases of the highway which however would have dramatic implications on Montenegro's soaring debt.

Serbia with a high total FDI inflow from China in comparison to its Southeast European neighbors but a relatively low BRI investment volume in comparison to its GDP seems to be able to mostly benefit from the initiative. While the country is profiting from Chinese infrastructure know-how, overcapacities and loans with low interest rates and long grace periods it is able to cope with the debt in a relatively unproblematic manner. Decreasing government debt levels confirm this claim that is supported by many international institutions reports on the country's finances. Nevertheless, smaller countries like Montenegro seem to be increasingly endangered by growing government debt. While on the first look the BRI appears to be an extremely good opportunity for many small countries with limited access to financial funds to further stimulate their economic growth and development one must not forget that there are also substantial uncertainties connected to these loans and every BRI must consider very carefully whether it is economically viable to undertake such an investment. The example of Hambantota port in Sri Lanka and also the debt developments in Montenegro show that the easily accessible funds can also pose a huge risk. The future will show whether Montenegro will be able to consolidate their fiscal policy in a time of an apparent slowdown in global growth. As suggested by the IMF it is crucial to refrain from implementing the second and third phase of the highway to guarantee the financial stability of the country. Only if a more sustainable financing measure is identified and the cross-border connection and coordination are further strengthened the continued development of the Bar Boljare highway would be sustainable.

China is facing a different economic environment with slowing economic growth and the ongoing trade war with the United States. Although that could make Chinese policy makers focus on stimulating domestic economic growth, so far, no clear signs could have been observed that the BRI would lose its importance as China's main international strategy. The BRI is most likely to be continued in its current form, if not even extended. Undebatable, the gains for the world economy will be significant in terms of trade growth and infrastructure development. Even countries that do not officially participate in the BRI will be able to gain from the initiative. But to guarantee that the BRI is mutual beneficial and in the interest of everyone in the world community it is crucial to avoid that small and debt-prone countries suffer from dramatically increasing government debt and the severe consequences implied.

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7. Affidavit

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