The creation of a Regional Investment Reform Agenda in the Western Balkans and its implications for Chinese investments: case study on the Republic of Macedonia

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ABSTRACT

At the EU-Western Balkans (WB) Summit held in Trieste in 2017, a decision was made to launch the creation of a WB Regional Economic Area. The objective is to increase growth and create jobs by promoting strengthened economic integration of the WB region. The steps leading to this goal include, inter alia, harmonization of national investment policies in the 6 WB economies with EU standards and best practices, by focusing on: enhancing entry and establishment procedures for investors, improving business establishment policies and procedures, aligning the legal framework for investment, strengthening investment retention mechanisms, developing a regional investment promotion initiative, streamlining incentives and improving their transparency and governance.

This paper aims to examine **the impact that the initiative may have on Chinese investments in the WB region**, focusing particularly on the Republic of Macedonia as a case study. Given the **very limited inflows of Chinese FDI in Macedonia** thus far, the basic assumption to verify or falsify is that **reforms in the area of investment policy in the WB region can be leveraged to attract more Chinese investors in Macedonia** and be mutually beneficial for both countries. The interplay of the **16+1 cooperation and the EU-China relations** will be considered in order to assess the synergetic/competitive influence of the broader geopolitical context.

The data collection methods will include a review of primary and secondary sources and survey/interviews of Chinese companies/business people present in Macedonia on their perceptions and expectations regarding the national investment policy towards Chinese investors. The research will consist of three parts: (1) review of the existing contractual framework between China and Macedonia in the area of investments and comparison with standard EU provisions that will be the future benchmarks; (2) analysis of the current situation regarding Chinese investments in Macedonia; (3) conclusions with predictions on how the situation may unfold and recommendations for both sides to maximize their benefits.

Introduction

Following the efforts to enhance Western Balkans (WB) regional cooperation within the framework of the Berlin process and especially at the last EU-Western Balkans summit which took place in Trieste, Italy in 2017, the countries from the WB region decided to engage in the creation of a Regional Economic Area. One aspect of the Regional Economic Area is the Regional Investment Reform Agenda (RIRA) which aims to harmonize investment policies among the 6 economies and with the EU best standards and practices. The main driver behind RIRA is the desire to attract more foreign investors in order to foster growth and create jobs, while upholding fair competition and sustainability. The latter is particularly important given the fact that the region has started to build an image as an investment destination with cheap and high-skilled labor, offering "dumping-like" government incentives and producing low-value goods, which essentially leads to a "race to the bottom" in terms of social, fiscal and environmental standards.

RIRA was adopted on 11 May 2018 and consists of 3 broad areas of action[1]:

- Investment entry and establishment – focusing on existing barriers to investment, business establishment policies and procedures;
- Investment protection and retention – focusing on reexamining international investment agreements (i.e. Bilateral Investment Treaties) and investor grievance mechanisms;
- Investment attraction and promotion – focusing on the joint promotion of the region as an attractive investment destination, streamlining governments' incentives and promoting their transparency and governance.

Given the different current situation in each of the 6 economies and their different starting points, the next step to be implemented is for the WB economies to develop National Action Plans which will define specific activities to achieve RIRA's goals. The Government of the Republic of Macedonia in September 2018 created an inter-ministerial taskforce that will be responsible for the oversight of RIRA and the creation and implementation of a National Action Plan. While RIRA is still in an embryonic phase, the article at hand aims to examine whether **reforms in the area of investment policy in the WB region can be leveraged to attract more Chinese investors in the region and in particularly in Macedonia.**

This is in particular relevant in the context of the Belt and Road Initiative (BRI) which is the Eurasian grand strategy of the People's Republic of China that seeks to expand and secure maritime routes and road infrastructure networks for China from Asia, across Africa, to the Middle East and Europe including South-East Europe. Providing loans at low interest rates, the acquisition of ports, opening of bank branches in the region or official lending for bridge building, highway construction and power plant renovation, creation of infrastructure of transport and logistics networks; all is a welcome development for the countries in the region especially Macedonia which is not a prime destination for foreign direct investments and faces limitations in terms of private sector lending.

[1] Regional Cooperation Council, *Regional Investment Reform Agenda*, 11.05.2018, retrieved from https://www.rcc.int/docs/410/regional-investment-reform-agenda-for-the-western-balkans-six, last accessed on 01.10.2018

The findings are based on input obtained through semi-structured interviews conducted with policy makers, as well as micro-survey with Chinese entrepreneurs who have invested in Macedonia or have tried to and gave up, representatives from big Chinese corporations with branch offices in Macedonia and Chinese financial institutions. A questionnaire was used to survey their degree of familiarity with the conditions to invest in Macedonia, as well as their perceptions regarding the visibility and publicity for investment opportunities, the ease of investing and doing business in the country, the main obstacles that they may face and the priorities when selecting an investment destination in general. Notwithstanding the limitations of the data collection method due mainly to the limited sample of respondents, language barriers and different surveying environment (in person vs. online), the obtained responses represent very similar and coherent perception. This implies that the insights are valid and solid basis for an initial analysis.

The article presents the following structure: the first part briefly examines the current situation regarding Chinese investments in the Western Balkans and focuses more specifically on Macedonia. The second part analyses the potential reasons behind the low level of Chinese investments as seen from the Chinese perspective. The third part analyses how the identified obstacles can be addressed through RIRA. The last part provides conclusions and specific policy recommendations.

The (non)existent Chinese investments in Macedonia

The recently signed agreement between the Serbian Government and Shandong Linglong to build a tire production plant near Zrenjanin worth almost 1 billion USD and hiring 1.200 workers[2] has probably made envious every government in the region. Until this investment, Chinese investments in the 5 WB countries[3] (both infrastructural and FDI), amounted to less than 3% of the overall Chinese FDI in Central and Eastern Europe[4] and represented an insignificant percentage compared to the overall Chinese investments in Europe. This is due in part to a mismatch between the WB investment opportunities and the priorities of Chinese companies when considering where to invest. While China favors mergers and acquisitions, technology transfers, acquisition of brands and advanced management skills, most WB countries look for green-field or brown-field investments that would create jobs and boost the local economies. Since the European economic and sovereign debt crisis and especially after the slowdown of Europe's economic growth in 2011[5], China, through its companies and their investments, sought to sustain growth and restructure the composition of the economy. Therefore, Chinese investors oftentimes focus not on immediate profit, but on long-term success, prefer to engage

[2] SEE New article, Shandong Linglong to open 1,200 jobs in Serbia in 2019 - chairman, 23.08.2018, retrieved from https://seenews.com/news/update-1-shandong-linglong-to-open-1200-jobs-in-serbia-in-2019-chairman-624409, last accessed on 28.10.2018

[3] Excluding Kosovo which is not a part of China's strategy for CEE.

[4] Liu, Z. quoted in Kratz, A., Stanzel, A. "*China's investment in influence: the future of 16+1 cooperation*", 14.12.2016, retrieved from http://www.ecfr.eu/publications/summary/chinas_investment_in_influence_the_future_of_161_cooperation7204, last accessed on 10.10.2018

[5] China GDP annual growth rate, data retrieved from https://tradingeconomics.com/china/gdp-growth-annual, last accessed on 11.10.2018

in mergers and acquisitions and to buy “discounted” Western European companies which can provide them with assets which take time to build and provide significant competitive leverage.

Table 1: Major Chinese Investments and Lending in Greece, Serbia, Macedonia, Bosnia and Herzegovina

Year	Country	Sector	Value in Billion/Millions €	State of Investments	Nature of Investments
'14	**Greece**	Transport/Container shipping	1.1 Billion	Completed	Official lending
		Transport/Container shipping	0.340 Billion	Completed	Shipping Infrastructure
		Transport/Container shipping	0.490 Billion	Completed	Shipping Infrastructure
		Transport/Container shipping	0.158 Billion	Completed	Shipping logistics
	Serbia	Energy	293-608 Million	Ongoing	Thermal Power plant at Kostolac
		Mihajlo Pupin Bridge over Danube	260 Million	Completed	Bridge Building
	Macedonia	Motorway Construction 110 km	574 Million	Completed	Lending/ Construction Kicevo-Ohrid, Miladinovci-Stip
		Railway	50 Million EBRD Secured Loan	Completed	Electrical trains/Railway Modernisation
	Bosnia-Herzegovina	Thermal Power Plant/Energy	722 Million	Framework & Lending Agreement, Seeking loan guarantee	15 % co-financing by EPBBiH, 85% loan from Exim Bank
'15	**Greece**	Energy	0.880 Billion	MoU	Energy generation
	Serbia	Auto Industry	60 Million	Completed	Obrenovac
	Macedonia	N/A	N/A	N/A	N/A
	Bosnia-Herzegovina	Transport	600 Million	Planning stage	Motorway Construction+Lending
		Energy	350 Million	Completed	Official lending+ Construction of thermal power plant
		Energy	388 Million	Tender Process ongoing	Thermal Power plant, Coal mine operation
'16	**Greece**	Transport Ports	0.280.5 Billion	Completed	Majority shareholding
	Serbia	Construction Corridor 11	350 Million	Ongoing	Cross Border Hughway Construction
		Steel Smederovo	46 Million	Ongoing	Modernisation Investments
		Rail reconstruction	Over 1 Billion	Ongoing	Fast Rail link Belgrade-Budapest
	Macedonia	N/A	N/A	N/A	N/A
	Bosnia-Herzegovina				
'17	**Greece**	Energy/Electricity	0.320 Billion	First stage completed-ongoing	24% shareholding (right to acquire 66% majority)
	Serbia	Sector banking	N/A	Completed	Greenfield investment, Branch network
	Macedonia	Electric locomotives	N/A	Ongoing	Supplementary investment to 2014
	Bosnia-Herzegovina				

Source: Authors presentation of data from EBRD, 2018

The overview of Chinese lending and investments in the last 3 years shows that Greece and Serbia have been quite successful in benefiting from Chinese capital invested in shipping, construction of motorways and energy, compared to Macedonia which is lagging behind. In Macedonia there have only been two major investments in infrastructure in 2014 and 2015 (constructing motorways and the modernization of the railway) and no major greenfield or brownfield investments so far. This is also in line with the decline of Macedonia’s proactive attitude within the 16+1 forum. According to a matrix to calculate the level of ambition in the China-CEE cooperation framework, Macedonia was ranked 8th, within the group of "ambitious" partners in the period 2013-2015, but fell to the 13th place in the period 2016-2018 and is now labeled as "follower"[6].

Considering that Macedonia was among the first countries in Central and Eastern Europe (CEE) to embrace the 16+1 cooperation and the BRI, there were great expectations that the country would increase its visibility in China, especially among Chinese policy makers and big companies, in order to create new avenues for economic cooperation and speed up its economic development. Hence, the strategy oriented mainly towards foreign direct investors that would open new factories or restart the old ones also enhanced the hopes of a more productive economic cooperation with China. Reinforced by the many reforms to improve the business environment, including fiscal policy reforms (introduction of low and flat tax rates, no tax on re-invested profit), creation of special zones for foreign investors with more favorable rules and regulations in comparison with investments outside the zones, (partial) exemption from certain public duties and charges, subsidies for construction of production plants and other production-related expenses, like machinery, creation of state agency tasked with attracting FDI and providing after-care support and services, etc. These efforts led to Macedonia ranking 11th worldwide according to the World Bank's Doing Business report in 2017[7]. There was even a plan to create special "free zones" for Chinese companies only, with even more favorable conditions. This proposal was put forth at every 16+1 summit in the first several years of the cooperation. Yet, not a single big Chinese company came to invest and stay in Macedonia and the overall level of Chinese investments remains below 0.1% of the total inward FDI[8].

Today the investment relations between both countries are governed by a bilateral investment treaty (BIT) signed in 1997. It's a standard agreement which aims to promote and protect respective investments on both sides by providing fair treatment, non-discrimination, dispute settlement mechanisms etc[9]. In addition, following the launch of the BRI, the two countries in 2014 signed a Memorandum of Understanding where China commits itself to "*encourage its companies to invest and develop in Macedonia, with priorities on industrial and technological cooperation in fields such as industrial parks, infrastructure, processing and manufacturing, energy, fishery and tourism*"[10]. Macedonia on the other side commits itself to "*work actively to create a favourable investment environment for Chinese companies*"[11]. From this perspective and given the low level of Chinese FDI, the Memorandum seems to hold more symbolic meaning than practical value.

[6] Oehler-Sincai, I.M., *A Reconfiguration of Sino-EU Relations under New Circumstances?*, 2018, forthcoming

[7] World Bank, *Doing Business Report*, 2018, retrieved from http://www.doingbusiness.org/data/exploreeconomies/macedonia-fyr, last accessed on 08.10.2018

[8] Calculation made by the authors on the basis of different publicly available sources: UNCTAD, IMF, NBRM, Hong Kong Trade Development Council

[9] Agreement between the Government of the Republic of Macedonia and the Government of the People's Republic of China on the encouragement and the reciprocal protection of investments, 1997, retrieved from http://investmentpolicyhub.unctad.org/Download/TreatyFile/757, last accessed on 08.10.2018

[10] Memorandum of Understanding between the Ministry of Economy of the Republic of Macedonia and the Ministry of Commerce of the People's Republic of China concerning promoting joint development of the Silk Road Economic Belt under the framework of China-Macedonia Joint Economic Committee", 2014

[11] *Ibid*.

Unlike big European countries which provide significant market potential and investment opportunities, Macedonia has a market of only 2 million. It offers solid conditions for doing business, especially in the free zones, FTAs which offer tax-free exports to a market of 500 million consumers, but the size of its market, along with its organization, or lack thereof, acts as impediment to big investments. The limited production output is not sufficient to satisfy the needs of bigger markets, such as China and ensure permanent supply. Most of the potential investment opportunities do not offer any technological or innovation advantages, nor brands that would be interesting for Chinese companies. With minor exceptions, this is also the case with the other WB economies.

Finally, it is still uncertain what the multiplier effect of the infrastructure investments would have over time. Namely, the Macedonian companies in the construction sector benefited from the motorway projects for the duration of such projects, but they do not offer sustainability and spill-over effects. It is expected however both the investment in motor ways and modernization of the railway to build closer trade ties with both China, but also European countries and especially exchange between the neighboring countries. However, to what extent these investments will impact SME development, additional job creation or a reversal of existing trade imbalances is still undetermined.

"Invest in Macedonia" – through the eyes of the Chinese businessman

When identifying the priorities for Chinese investors, the most salient and common choice they all make among 10 given options is *Government support and incentives (100%)*. Likewise, when asked what the main obstacle is for Chinese investors to invest in Macedonia, their choice of preference is *Lack of government support and incentives (88%)*. Given that an important component of the strategy to attract foreign investors was until recently the support that the government provided to foreign investors, especially in the free zones, it is worth examining why there is such a widespread perception among Chinese investors that there is not (enough) government support and incentives. A part of the explanation can be sought in the level of information that Chinese investors obtain regarding the investment opportunities and incentives.

While the majority of them claim to be at least partially familiar with the conditions to invest, 38% of them have not seen *any publicity among Chinese investors* about the investment opportunities in the country. Many of them believe that Macedonia, as a country in general, is rather unknown to the average Chinese. It seems that the ample promotional campaigns and activities of various sorts (TV and newspaper/magazine commercials, business forums etc.) organized and delivered by the previous government did not produce the desired results when it comes to attracting Chinese business investors. The promotional channels and media outlets that were used (Financial Times, Forbes, CNN etc.) are not the most suitable in order to reach Chinese investors. Many traditional Western media, social media, websites and applications are either not popular, influential or even accessible in China. Thus, a more detailed analysis of the promotional and advertising strategy needs to be conducted in order to identify the channels of preference for Chinese business people.

Another potential reason for the perceived lack of information and government support and incentives is the capacity, professionalism and integrity of the administration that is at the forefront in dealing with Chinese investors. As one interviewee points out: "*Good policies can be easily blocked in practice by a lazy bureaucrat or a corrupt one*"[12]. In this context, the link between the highest political level and the civil servants working in the area of investments should be strengthened, in order to improve the oversight, management and quality of policy implementation. This would be beneficial to identify whether the problem lies within the quality of the policies, as considered by half of the respondents, or within their practical implementation as it is often underlined by the EU in its reports. In addition, efforts should be made to ensure that possible miscommunication and misunderstanding do not occur because of intercultural and linguistic barriers, as believed by 40% of the surveyed businessmen.

While half of the respondents think that market size is important when choosing investment destinations in order to enable economies of scale, only a quarter see the size of the Macedonian market as an obstacle to investment. This can be related to the level of integration of the Macedonian economy in Europe and the Free Trade Agreements (FTA) that enable exports with no additional charges for products of Macedonian origin to a market of 500 million consumers. In this context, the survey reveals that whether Macedonia is not an EU or NATO member does not seem to be of any relevance for Chinese investors.

The issue of obtaining visas is considered an obstacle by 75% of the respondents. Since the initiative to bilaterally eliminate visas was officially announced around one year ago, the expectations on the Chinese side rose high. Should the current standstill on that path persist, there will certainly be a dose of additional disappointment and negative impact on the prospects for attracting Chinese investors.

RIRA: obstacles and opportunities for Chinese investors

As one Macedonian high-ranking civil servant points out, "*one of the biggest risks for the implementation of RIRA and at the same time the biggest reason behind (some) governments' reluctance to engage more proactively is the fear to be deprived of their biggest "asset" – the control over the policies and incentives*"[13]. For a very long time the countries in the region have considered themselves competitors in attracting FDI, that today they hardly know how to cooperate in that area. This is also supported by the fact that the composition of their economies is very much alike, not complementary but competitive and they see incentives as the only aspect which can bring them a competitive edge[14]. Given the importance bestowed on government support and incentives by Chinese businessmen, the effort to streamline and improve the governance of the incentives through RIRA would appear to be counterproductive to attract Chinese business people.

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[12] Personal interview with a Chinese official, 15.10.2018

[13] Personal interview with a high-level representative from the Ministry of Economy of the Republic of Macedonia, 04.09.2018

[14] Ibid.

Competitive attitude based on the differences between the countries can be beneficial for foreign investors - in this case China - for its own gains and profits and lead to a race to the bottom in terms of incentives, concessions and deviations from the rules and best practices. Nevertheless, it is also an obstacle for China to adopt a more targeted and integrated regional approach which would enable large-scale projects and investments. An increased convergence of the rules among the economies would also facilitate the "learning process" and allow for China and its companies to transfer and use the regulatory know-how and experience gained in one country throughout the entire region and more broadly in Europe. It will also help to avoid scenarios like the one following the acquisition of Piraeus Port in Athens by Chinese COSCO, when social protection standards were seriously undermined and Chinese investors faced a wave of criticism and bad image across Europe[15]. Chinese companies are aware of this criticism and they have since begun to pro-actively engage with civil society representatives, non-governmental organizations, chambers of commerce and universities on issues ranging from the transfer of professional skills, environmental impact assessment or strategic SME development.

The fact that Chinese companies have become very skilled at investing in EU Member States and Chinese investments in the EU per capita largely exceed those in the Western Balkans implies that EU's rules and policies *per se* are not deterring Chinese investors, on the contrary. Moreover, enhanced respect for rules and standards would be beneficial in cases of political and economic instability, investments with low returns or without guarantees, and possible illegal or unethical behavior by individual companies which could result in damage for the reputation of Chinese investments in general. This is all the more visible with the current investigations into the former Macedonian government's business deals with Chinese companies Yutong and Sinohydro. Thus, more transparent and better governed incentives will help to restore mutual trust and also to improve the overall image of Chinese companies in Macedonia.

With the EU accession process, Macedonia will transfer the exclusive competence in terms of investments to the EU institutions. In the meantime, the EU is negotiating a BIT with China on behalf of its Member States which will become binding for Macedonia and the other WB countries after they join the EU. In addition, it is about to adopt legislation which will introduce a compulsory FDI screening procedure by the European Commission targeting investments from third countries, namely China[16]. The purpose will be to identify and prevent investments which "*may affect projects or programs of Union interest on the grounds of security or public order*" and to verify whether "*a foreign investor is controlled by the government of a third country, including through substantial funding".*[17] Both initiatives have created a certain amount of fear among smaller EU Member States that the new instruments in the hand of the European Commission could be used to divert investments from and into certain

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[15] Hanemann, Thilo, *How Europe should respond to growing Chinese investment*, Rhodium Group, September 2012, available at http://esharp.eu/essay/14-how-europe-should-respond-to-growing-chinese-investment/, last accessed on 15.09.2018

[16] European Commission, *Staff Working Document accompanying the document Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union*, September 2017, retrieved from http://eur-lex.europa.eu/legal- content/EN/TXT/PDF/?uri=CELEX:52017SC0297&from=EN, last accessed on 15.09.2018

[17] *Ibid*.

countries[18]. In that context, RIRA will be beneficial as a learning process for the Macedonian institutions to better understand the EU rules of the game, to adapt to the clauses of the new investment agreement that they will have to adhere to and to learn how to attract investors while navigating the new system.

While many aspects related to the economy are given (size, resources etc.), there is also a multitude of parameters that can be improved and RIRA is a good starting point. Chinese business people, like any other, need and expect political, economic, legal and institutional stability, as well as support from the government institutions to invest and conduct their operations. RIRA can provide a much needed screening of all the procedures and policies which need improvement in order to enable easier market access and business operations for Chinese investors. In addition, promoting the WB region as a joint investment destination can be synergetic to the promotion of Macedonia itself. This would be highly beneficial to inform and attract Chinese investors who are not familiar with the country or its investment policies.

Conclusions and recommendations

Macedonia as well as the other WB economies need to "reinvent" themselves and their investment opportunities in order to be more attractive for Chinese investors. A thorough analysis should be conducted in order to identify some kind of competitive edge for each of them and areas where their mutual cooperation is possible, desirable and feasible. They also need to adopt a responsive and proactive attitude and adjust their offer to the evolving priorities of Chinese investment strategy. While the investment opportunities and policies may not be the reason for the low level of investments, the entire process of promotion, attraction and business operation needs to be reviewed and improved. Particular attention needs to be addressed to the issues of administrative capacity in order to strengthen the transparency, implementation and oversight of investment policies.

With the ongoing/forthcoming EU accession process for all the economies, as well as the prospects of membership and acceptance of EU's acquis in the area of investments, there is no need to re-examine or attempt to modify the bilateral legal framework for investments. The time and energy allocated to this task within RIRA could be instead used to develop more transparent and better governed investment incentives. While they will be intended for attracting foreign investors in general, they need to be further tailored to reach the Chinese companies. Thus, a new communication and visibility strategy needs to be put in place which will take into account the specificities of the Chinese practices and habits in terms of media, social media and advertising. This applies to the promotion of individual countries, as well as the joint promotion of the WB region as an investment destination.

Efforts should be made to overcome linguistic and cultural differences which are another obstacle to a more intensive economic cooperation. Confucius institute has been opened in Skopje in

[18] Seaman, J., Huotari M., Otero-Iglesias, M., *Chinese Investment in Europe: a country-level approach*, Report by the European Think-tank Network on China (ETNC), December 2017, retrieved from https://www.pism.pl/files/?id_plik=23889, last accessed on 01.10.2018

2013 which offers free language classes for different interested parties - schools, companies, ordinary citizens and even civil servants since 2015. Its services should be leveraged to train a pool of civil servants who would be able to attract and support interested Chinese investors throughout the process.

Better mutual understanding, more intensive communication and exchange, as well as respect for the rules and best practices on both sides will foster long-term business relations based on trust and improved image on both sides. All this requires improving the governments' understanding and knowledge of the Chinese needs, priorities and business culture, adopting a proactive attitude and developing a mid to long term strategy on China.

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