

## Western Balkans: The burden of China's lending to governments

- There has been increasing attention on China's lending to governments in the Western Balkans<sup>1</sup> due its geopolitical and economic implications.
- In this note, we focus on this lending, its size and the burden it places on public finances.
- Loans are provided by the China Import-Export Bank with maturities of 15-20 years at interest rates of 2-3% and focus on infrastructure.
- China's lending is large for most countries. The contracted amount is 3% of GDP in Bosnia and Herzegovina, 7% in Serbia, 8% in North Macedonia, and 21% in Montenegro. There is no lending to Albania.
- Annual average repayments are below 1% of GDP for all except Montenegro (1.8%), amounting to EUR 57mn for North Macedonia, EUR 60mn for Bosnia and Herzegovina, EUR 77mn for Montenegro and EUR 233mn for Serbia.
- The repayments account for less than 10% of total funding needs in 2021-23 for all countries except Montenegro, where they represent on average 40% of total funding needs in 2022 and 2023.
- China is not the main external creditor but its share in government external debt will likely increase if loans are disbursed in line with contracts.
- This could be counterbalanced by a greater role being played by EU funds to finance infrastructure projects, thanks to the Western Balkan Investment Plan, which could provide grants of 7% to 18% of GDP for the period 2021-27.

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<sup>1</sup>In this note, we consider Albania, Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia. Bosnia and Herzegovina is a potential EU candidate, therefore, although it has not started the EU accession process yet, it could start once some prerequisites are in place. The other countries are EU candidates and have already started, or are about to start, the EU accession process.

## Introduction

**Increasing concerns voiced about China's investment in the Western Balkans**

There has been increasing attention on China's lending to governments in the Western Balkans due its geopolitical and economic implications. This lending has certainly contributed to addressing significant infrastructure needs. The rapid availability of this funding with few prerequisites was probably the biggest incentive for Western Balkan governments to borrow from Chinese entities. However, there are some concerns: EU officials have warned against China's increasing presence from a geopolitical perspective<sup>2</sup>; in addition, there have been concerns about the excessive fiscal burden of some of the projects and the environmental impact<sup>3</sup>.

**Concerns also relevant for financial markets**

These concerns are also relevant for financial markets, due to their potential economic and fiscal implications. Recently, for example, worries about the loan Montenegro obtained from China to build a highway contributed to pronounced volatility in the country's government bond yields in mid-April, when the yield on the MONTEN 12/27 EUR bond spiked above 5%. Investors remained concerned, with the yield currently around 4.3%, around 0.7pp above the levels registered before the government asked for EU support in repaying the Chinese loan.

**Focus on China's lending to the governments of the region, its size and the burden on public finances**

In this note, we focus on China's lending to governments and state-owned enterprises (SOEs) in the region, its size and the burden it places on public finances. In a subsequent note, we will complete the picture by focusing on Chinese FDI in the region.

**A challenge: collecting the data**

Since there is no readily available data on China's lending to the Western Balkans, we collected the data on individual projects by looking at the various debt reports, budget laws and laws on the agreement of state guarantees for SOEs from the individual countries' ministries of finance<sup>4</sup>. Therefore, we included only projects for which the agreement on a loan was finalized and officially reported.

## China's lending targets large infrastructure projects

**China's lending mainly through China EXIM**

China's lending to government and state-owned enterprise in the Western Balkans mainly takes place through the China export-import bank (China EXIM), a state-funded and state-owned policy bank whose main task is to support China's foreign trade, investment and international cooperation. China EXIM typically funds 85% of the cost of the project, with the rest financed by Western Balkan governments from local sources.

**Focus on infrastructure projects with long term loans**

These loans mainly fund large infrastructure projects. They are typically for 15-20 years, with a five-year grace period and interest rates of between 2% and 3%. They typically carry a commitment fee on undisbursed funds of 0.25-0.5% and a one-off management fee of 0.5%. The repayment schedule is generally (but not exclusively) an equal semi-annual repayment (constant annuities) for the period considered.

**We summarize the information on the projects in an overview table**

The table below shows the various projects funded by CHINA EXIM by country, with the amount contracted, the outstanding amount, year of approval, maturity, first year of repayments and the repayment in 2021 (figures in red are our estimates). The amounts are also shown as percentage of GDP.

**No Chinese loans for Albania**

Albania is the only country of the group considered which does not have a loan from China EXIM, although it has engaged in discussions with China EXIM for some projects in the past.

<sup>2</sup>See for example the former European Commissioner for European Commissioner for European Neighbourhood Policy and Enlargement Negotiations, Johannes Hahn <https://www.politico.eu/article/johannes-hahn-beware-chinese-trojan-horses-in-the-balkans-eu-warns-enlargement-politico-podcast/>

<sup>3</sup>On the environmental impact, please see for example <https://www.reuters.com/article/us-bosnia-eu-energy-idUSKBN1QU1JD>

<sup>4</sup>With our approach we build on previous analyses by Barisitz and Radzyner (2017a, 2017b), Barisitz (2020), AidData (2017) and Dreher, A., Fuchs, A., Parks, B.C., Strange, A. M., & Tierney, M. J. (2017) . Please see the Annex for details about the data sources.

**TABLE 1: LOANS FROM CHINA EXIM TO GOVERNMENTS AND STATE-OWNED ENTERPRISES IN THE WESTERN BALKANS BY COUNTRY AND BY PROJECT**

Project	Type	Contracted amount			Outstanding amount		Year of approval	Maturity, years	Interest rate, %	First year	Repayment	
		In original currency, mn	EUR mn	% GDP	EUR mn	% GDP					2021, EUR mn	2021, % GDP
<b>Bosnia and Herzegovina</b>												
Building of block 7 of the Tuzla thermal power plant	Guarantee on loan by SOE	613 (EUR)	613	3.4	0	0	2019	20	EURO LIBOR 6m + 2.3	2024	0	0
<b>Total</b>		<b>613 (EUR)</b>	<b>613</b>	<b>3.4</b>	<b>0</b>	<b>0</b>					<b>0</b>	<b>0</b>
<b>Montenegro</b>												
Procurement and overhaul of ships – maritime transport company	Guarantee on loan by SOE	48 (USD)	40	1.0	-	-	2010	15	3.0	2015	6	0.1
Procurement and overhaul of ships – Bar maritime transport company	Guarantee on loan by SOE	48 (USD)	40	1.0	-	-	2013	15	3.0	2018	6	0.1
Construction of the Bar-Boljare motorway	Loan to government	944 (USD)	787	18.8	.	-	2015	20	2.0	2021	30	0.7
<b>Total</b>			<b>867</b>	<b>20.7</b>	<b>641</b>	<b>15.3</b>					<b>41.6</b>	<b>1.0</b>
<b>North Macedonia</b>												
Construction of the motorway between Ohrid and Kičevo	Loan to government	505 (USD)	421	3.9	-	-	2014	20	2.0	2019	39	0.4
Construction of the motorway between Miladinovci and Štip	Loan to government	278 (USD)	232	2.2	-	-	2014	20	2.0	2019	22	0.2
Construction of the motorway between Ohrid and Kičevo, additional funding	Loan to government	180 (USD)	150	1.4	-	-	2019	20	2.0	2024		
<b>Total</b>			<b>803</b>	<b>7.5</b>	<b>457</b>	<b>4.2</b>					<b>61.0</b>	<b>0.6</b>
<b>Serbia</b>												
Purchase of border scanning equipment	Loan to government	205 (CNY)	26	0.1	11	0.0	2009	15	3.0	2014	2	0.0
Zemun-Borca Bridge and the accompanying roads project	Loan to government	217 (USD)	181	0.4	114	0.2	2011	20	3.0	2016	14	0.0
Highway E763 (Obrenovac-Ljig)	Loan to government	301 (USD)	251	0.5	226	0.5	2014	20	2.5	2019	17	0.0
Power-plant project Kostolac B / I phase	Loan to government	287 (USD)	239	0.5	158	0.3	2012	15	3.0	2017	25	0.1
Power-plant project Kostolac B / II phase	Loan to government	608 (USD)	507	1.1	146	0.3	2014	20	2.5	2022	0	0.0
Highway E763 (Surcin-Obrenovac)	Loan to government	199 (USD)	166	0.4	165	0.4	2017	20	2.5	2022	0	0.0

Project	Type	Contracted amount			Outstanding amount		Year of approval	Maturity, years	Interest rate, %	First year	Repayment	
		In original currency, mn	EUR mn	% GDP	EUR mn	% GDP					2021, EUR mn	2021, % GDP
Modernization and reconstruction of Hungarian-Serbian railway line, Belgrade Center-Stara Pazova section	Loan to government	298 (USD)	248	0.5	110	0.2	2018	20	2.0	2022	0	0.0
Belgrade bypass project - highway E70/E75, section: bridge over Sava near Ostruznica-Bubanj Potok (Sectors 4, 5 and 6)	Loan to government	1,437 (CNY)	184	0.4	87	0.2	2019	20	2.5	2024	0	0.0
Construction of highway E-763, Preljina-Pozega section	Loan to government	445 (USD)	371	0.8	79	0.2	2019	20	3.0	2024	0	0.0
Project of modernization and reconstruction of Hungarian-Serbian railway connection, Novi Sad-Subotica state border (Kelebija) section	Loan to government	988 (USD)	824	1.8	0	0.0	2019	20	2.0	2024	0	0.0
Construction of district heating pipeline project Obrenovac-Novı Beograd	Loan to government	165 (USD)	165	0.4	0	0.0	2020	20	Euribor 6M + 2.7	-	0	0.0
Rescheduled obligations	Loan to government	101 (USD)	84	0.2	4	0.0	-	-	Libor USD 6M +1.30	2010	4	0.0
<b>Total</b>			<b>3,244</b>	<b>7.0</b>	<b>1,100</b>	<b>2.4</b>					<b>61</b>	<b>0.1</b>

Source: ministries of finance, local parliaments, Serbia Public Debt Agency, press reports (for Montenegro repayments for 2021), Dreher, A., Fuchs, A., Parks, B.C., Strange, A. M., & Tierney, M. J. (2017) (for Serbia: the date of approval of the Serbia project Kostolac B /phase 2: Montenegro for the interest rates on the projects relating to the procurement and overhaul of ships and the grace periods), figures in red are our estimates, UniCredit Research (see Annex for more details)

## China's lending is large relative to the size of most economies

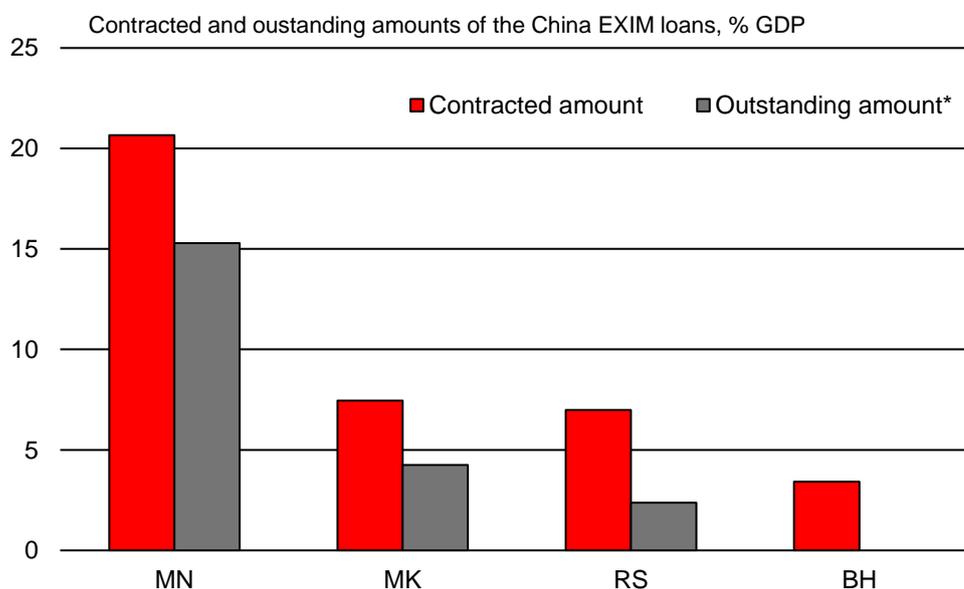
China's lending is significant for most countries

China's lending to governments and SOEs in the Western Balkans is large relative to the size of their economies for most countries. The contracted amount of lending as a percentage of 2020 GDP is 3.4% in Bosnia and Herzegovina; 7% in Serbia, which has the largest number of projects; 7.5% in North Macedonia and 20.7% in Montenegro (Table 1).

The contracted amount has not yet been fully disbursed

The funds provided through these loans are disbursed over several years, therefore the contracted amount does not yet appear in full in the official debt statistics, as they include only the part of the funds that has been disbursed. The outstanding amount is the amount disbursed minus repayments.<sup>5</sup> It is 0% of contracted loans in Bosnia and Herzegovina, as there have been no disbursements yet, 34% in Serbia, 56% in North Macedonia and 74% in Montenegro. Chart 1 compares contracted and outstanding amounts as a percentage of GDP.

CHART 1: CHINA EXIM LOANS, CONTRACTED AND OUTSTANDING AMOUNTS, % OF GDP



\*4Q20 for Bosnia and Herzegovina and Serbia, 3Q20 for Montenegro, 4Q20 for North Macedonia is our estimate, see Annex for details

Source: ministries of finance, local parliaments, Serbia Public Debt Agency, press reports, UniCredit Research (see Annex for more details)

## Annual repayments less than 1% of GDP in most countries

Repayments schedule is estimated

There is no public schedule for the repayments, for our table we used either what ministries of finance have communicated publicly on an ad-hoc basis or our estimates based on information about the loans.

No issues for 2021 repayments

Repayments for the loans in 2021 range from zero, for loans still in the grace period, to close to EUR 61mn in North Macedonia<sup>6</sup>. All governments have set aside enough funding to cover these financing needs in 2021, therefore we do not see any repayment issue. In terms of GDP, 2021 repayments are equal or less than 1% in all countries.

<sup>5</sup> For the older loans, for example in Serbia, it can also be that the project was completed using less funds than originally planned, therefore the outstanding loan could be the final figure.

<sup>6</sup> For Montenegro we use the figure announced by the ministry of finance in 2019, EUR 30mn. The estimate annual payment would be EUR 90mn.

On average, annual repayments over the life of the loans are below 1% of GDP for all countries, except Montenegro (1.4%)

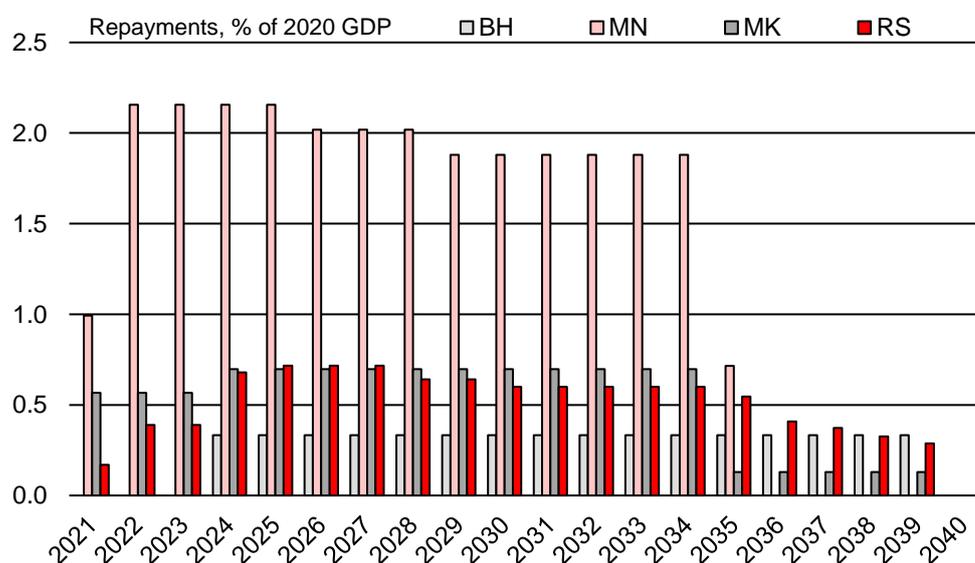
In euros, annual repayments range from EUR 43mn to EUR 165mn on average

Looking at the whole life of the loan, we estimate annual repayments will remain below 1% of 2020 GDP in all countries except Montenegro, where we estimate it on average at 1.8% of GDP. We estimate the annual repayments using the interest rate on the specific loans, a one-off fee of 0.25%, the related maturity and grace periods.

On average, annual repayments in the period 2021-40 are EUR 57mn for North Macedonia, EUR 60mn for Bosnia and Herzegovina, EUR 77mn for Montenegro and EUR 233mn for Serbia. These amounts can be financed in the market and/or from international financial institutions (IFIs), in case of need. Alternatively, Western Balkan countries can free up budgetary resources to repay these loans by using EU transfers to fund investment projects. While loan repayments can be covered, they could crowd out some public spending, leading to a higher primary balance.

Chart 2 below shows the repayment profile as a percentage of 2020 GDP from 2021 to 2040.

**CHART 2: REPAYMENTS SCHEDULE FROM 2021 TO 2040 BY COUNTRY**



Source: ministries of finance, local parliaments, Serbia Public Debt Agency, press reports (for the North Macedonia and Montenegro repayments for 2021), UniCredit Research

Repayments are less than 10% of total funding needs in 2021-23 for most countries

Repayments are less than 10% of total funding needs in 2021-23, with the exception of Montenegro in 2022 and 2023, where they are around 40% on average. Table 2 below shows total financing needs and China EXIM repayments as percentage of GDP and as a percentage of total financing needs. Financing needs are taken from the countries' Economic Reform Programmes, except for Serbia, where figures are based on the 2021 budget, our forecast for 2022 and the medium-term fiscal strategy for 2023.

**TABLE 2: GOVERNMENT FINANCING NEEDS AND CHINA EXIM REPAYMENTS**

	2021	2022	2023
<b>BH</b>			
Total financing needs, % GDP	7.0	5.7	6.3
China EXIM repayment			
% GDP	-	-	-
% of total financing needs	-	-	-
<b>MN</b>			
Total financing needs, % GDP	12.7	6.2	3.4
China EXIM repayment			
% GDP	0.9	1.8	1.7
% of total financing needs	7.1	29.1	49.7
<b>MK</b>			
Total financing needs, % GDP	11.1	5.3	9.2
China EXIM repayment			
% GDP	0.5	0.5	0.5
% of total financing needs	4.8	9.4	5.0
<b>RS</b>			
Total financing needs, % GDP	14.7	9.1	7.7
China EXIM repayment			
% GDP	0.2	0.3	0.3
% of total financing needs	1.1	3.6	4.0

Source: ministries of finance, local parliaments, Serbia Public Debt Agency, press reports governments' Economic Reform Programmes, UniCredit Research

## China is not the main external creditor but its importance will increase

China is not the main external creditor of governments in the region.

In Table 3, we compare the share of outstanding total external government debt for the various creditors, including Eurobonds. For comparability, for North Macedonia we also added the outstanding loan from China EXIM, which is actually disbursed to a state-owned enterprise, therefore the total external debt is different to the official statistics (given that there are no official data on this amount, we estimated the outstanding loan from China EXIM by assuming an average disbursement of 10% of the contracted amount per year, which is similar to the average disbursement of the contracted amount for Montenegro's highway so far). For all countries, we added all Eurobonds outstanding. The analysis is possible only for outstanding debt. Therefore, the shares reflect only the financing disbursed by creditors, not the full amount contracted.

Eurobonds have the highest share in government external debt, followed by loans from the EU and IFIs combined. China is the third or fourth-largest creditor for most countries. Bosnia and Herzegovina is an exception, with the EU and IFIs having a combined share of close 80% and the rest accounted for mainly by other official creditors.

However, China's share in external debt is likely to increase in the coming years as more of the contracted loans is disbursed.

In Table 4, purely for illustrative purposes, we replace the outstanding amount of Chinese loans with the contracted value. As a result, China's share increases significantly in some cases. Obviously, while in this exercise we keep all the other amounts equal, in reality they will increase as well. Therefore, the potential increase in the share of Chinese debt is overstated.

**China's share of government external debt is smaller than that of Eurobonds and borrowing from the EU and IFIs**

**China's share of external debt is likely to increase in the coming years**

**TABLE 3: SHARE OF TOTAL OUTSTANDING GOVERNMENT EXTERNAL DEBT BY CREDITOR RANKED BY SIZE<sup>7</sup>, %**

	BH		MN		MK		RS
EU+IFIs	75.6	Eurobond	48.4	Eurobond	65.1	Eurobond	40.5
Other	14.5	EU+IFIs	28.0	EU+IFIs	19.3	EU+IFIs	25.9
Eurobond	9.8	China	18.4	China	8.9	Other	21.9
China	0.0	Other	5.1	Other	6.6	China	7.3
Russia	0.0	Russia	0.0	Russia	0.0	Russia	4.4

Source: ministries of finance, local parliaments, Serbia Public Debt Agency, UniCredit Research,

**TABLE 4: SHARE OF OUSTANDING TOTAL GOVERNMENT EXTERNAL DEBT BY CREDITOR, USING TOTAL CONTRACTED AMOUNT FOR CHINA, RANKED BY SIZE<sup>8</sup>, %**

	BH		MN		MK		RS
EU+IFIs	67.0	Eurobond	45.9	Eurobond	59.5	Eurobond	35.5
Other	12.9	EU+IFIs	26.5	EU+IFIs	17.7	EU+IFIs	22.7
China	11.4	China	22.7	China	16.8	Other	19.2
Eurobond	8.7	Other	4.9	Other	6.0	China	18.8
Russia	0.0	Russia	0.0	Russia	0.0	Russia	3.9

Source: ministries of finance, local parliaments, Serbia Public Debt Agency, UniCredit Research

## A greater role for EU funding to finance infrastructure

The increasing role of China as creditor to the governments of the Western Balkans could be counterbalanced by the EU playing a greater role in the funding of infrastructure investment, thanks to the Western Balkan Investment Plan (WBIP), approved in October 2020.

**Western Balkans could use more EU transfers to fund investment**

As mentioned in our [EEMEA Country Note – Not alone: Financial support of the Western Balkans](#), 20 January, EU transfers will represent an important source of financing for the medium-term. We estimate that funding through the EU's WBIP, EUR 9bn of grants in total, could range from 7% to 18% of 2019 GDP, therefore representing a significant amount.

**Western Balkans will also benefit from IFI funding**

Furthermore, the Western Balkans are expected to benefit from additional funding from other IFIs, such as the World Bank, the European Bank for Reconstruction and Development, and the European Investment Bank. In the past five years, on average, this funding has ranged from 1.1% to 2.2% of 2019 GDP per year, depending on the country, according to our estimates<sup>9</sup>.

**The process of EU accession could bring additional EU funding**

The process of EU accession could bring additional EU funding. The new EU accession process envisages the possibility of gradually benefiting from additional EU transfers in return for progress on the implementation of reforms.

Progress on EU accession will also improve credibility and help Western Balkan countries to tap debt markets. Serbia's experience shows that countries with an EU accession roadmap and an improving fiscal situation can benefit from declining yields and longer maturities.

<sup>7</sup>For Bosnia and Herzegovina data refer to 4Q20. For Montenegro data refer to 3Q20 but we added also the Eurobond issued in December 2020. For North Macedonia data refer to 4Q19 and the outstanding of the China loan is out estimate (see Annex for details) but we added also the Eurobonds issued in 2020 and 2021. For Serbia data refer to 4Q20, but we added also the Eurobonds issued in 2021.

<sup>8</sup>See previous footnote.

<sup>9</sup>These figures are our estimates based on the financing of projects of the various institutions. It includes all World Bank projects. For the EIB it includes direct financing related to large public infrastructure projects, therefore it does not include the financing to the private sector through banks, which is substantial. For the EBRD it includes all financing for public sector projects, therefore it does not include financing to the private sector, which is substantial. The data report the value of the agreed loan in a particular year but disbursement could take place over several years.

Expensive Chinese funding with no conditionality vs free/cheaper EU and IFI funding with reforms

## Concluding remarks

Rapid availability of funding and few prerequisites were probably the biggest incentives for Western Balkan governments to borrow from Chinese entities. While China is one of the largest creditors to the region, these countries can diversify funding sources before the burden of debt repayments to China becomes too large. The EU and IFIs are the easily available option, while an improving fiscal story and progress towards EU accession could unlock more market funding.

Thus, the Western Balkans have to balance the need to improve infrastructure with the cost of achieving this goal, since potential gains from new highways, bridges, railways and power plants (either directly from tariffs and tolls, or indirectly through higher tax receipts on more trade) may not be sufficient to cover the borrowing costs.

The cost and conditions under which countries of the Western Balkans can reduce their debt to China is yet unclear. The situation is made all the more difficult by existing Chinese FDI, which will be analyzed in a subsequent note.

## Annex: data sources for Table 1

We included only projects for which the agreement on a loan had been finalized and officially reported with the following exceptions. For North Macedonia and Montenegro, for the contracted amount, we used amount approved as guarantee in the Official Gazette.

There are no official data on North Macedonia's outstanding debt related to China Exim loans. In forming our estimates, we assumed an average disbursement of 10% of the contracted amount per year. This is similar to the average disbursement of the contracted amount for Montenegro's highway.

We used the database of Dreher, A., Fuchs, A., Parks, B.C., Strange, A. M., & Tierney, M. J. (2017) for the date of approval of the Serbia project Kostolac B/phase 2 and for the interest rates on the Montenegrin projects relating to the procurement and overhaul of ships and the grace periods.

For the 2021 repayments relating to the Montenegrin highway, we used information communicated publicly by the finance minister in 2021. For the other two projects for Montenegro, we used our own estimates. For North Macedonia's repayments, we used our own estimates.

Data sources more in detail:

1. Bosnia and Herzegovina: The *Official Gazette of Bosnia and Herzegovina*, quarterly reports on external debt
2. Montenegro: *Medium-Term Debt Management Strategy 2018-2020*, report on the public debt of Montenegro 2014, reports on central government debt
3. North Macedonia: The *Official Gazette of the Republic of North Macedonia*, quarterly reports on government debt
4. Serbia: Public Debt Administration quarterly reports

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