

Hake, Mariya; Radzyner, Alice

Research Report

Western Balkans: Growing economic ties with Turkey, Russia and China

BOFIT Policy Brief, No. 1/2019

Provided in Cooperation with:

Bank of Finland, Helsinki

Suggested Citation: Hake, Mariya; Radzyner, Alice (2019) : Western Balkans: Growing economic ties with Turkey, Russia and China, BOFIT Policy Brief, No. 1/2019, Bank of Finland, Institute for Economies in Transition (BOFIT), Helsinki,
<https://nbn-resolving.de/urn:nbn:fi:bof-201902151067>

This Version is available at:

<https://hdl.handle.net/10419/251684>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.


Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

BOFIT Policy Brief
2019 No. 1



Mariya Hake and Alice Radzyner

Western Balkans: Growing economic ties
with Turkey, Russia and China



Bank of Finland, BOFIT
Institute for Economies in Transition

BOFIT Policy Brief
Editor-in-Chief Juuso Kaaresvirta

BOFIT Policy Brief 1/2019
15 February 2019

Mariya Hake and Alice Radzyner: Western Balkans: Growing economic ties with Turkey, Russia and China

ISSN 2342-205X (online)

Bank of Finland
BOFIT – Institute for Economies in Transition

PO Box 160
FIN-00101 Helsinki

Phone: +358 9 183 2268

Email: bofit@bof.fi
Website: www.bofit.fi/en

The opinions expressed in this paper are those of the authors and do not necessarily reflect the views of the Bank of Finland.

Contents

Abstract	4
1. Western Balkan countries: Attracting financing on the way to EU accession.....	5
2. Building institutional ties in the Western Balkans.....	6
2.1. Turkey: rethinking its Western Balkan strategy in light of own gloomy EU accession prospects.....	6
2.2. Russia: leaving a foot in the doorway	7
2.3. China: quick and easy financial injections.....	8
3. A brief take on the economic exposure of the Western Balkans to China, Russia and Turkey.....	9
4. Banking sectors in the Western Balkans: the economic ties that bind.....	12
5. Conclusions.....	13
References.....	15
Annex	17

Mariya Hake¹ and Alice Radzyner²

Western Balkans: Growing economic ties with Turkey, Russia and China³

Abstract

Although the European Union (EU) countries constitute the largest trade partner and investor of the Western Balkan economies, economic exposure in terms of trade and investments to Turkey, Russia and China has been on the rise in the past decade. Turkey is among the top trading partners of Serbia and Bosnia and Herzegovina, while its investments in the banking sectors in the rest of the Western Balkan economies is gaining also in importance. Going further, the trade volume with Russia is overall small except for Serbia, however, Russian investments are sizable in key sectors (e.g energy, real estate) in Montenegro and Bosnia and Herzegovina. Financial and economic ties with China have intensified particularly between 2015 and 2017, not least because the region is part of the New Silk Road and the so-called “16+1 format”. China invests in regional infrastructure, such as ports, railroads and highways mainly in Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro and Serbia. Overall, the growing influence of non-EU global players poses an additional pressure on the EU to thoroughly follow its Western Balkan strategy.

Keywords: Western Balkan countries, trade, investment, Turkey, Russia, China

¹ Corresponding author: Oesterreichische Nationalbank, Foreign research division, E-mail: mariya.hake@oenb.at.

² Oesterreichische Nationalbank, European Affairs and International Financial Organizations Division, E-mail: alice.radzyner@oenb.at.

³ This contribution expresses the views of the authors and not necessarily the view of the Oesterreichische Nationalbank or the Eurosystem.

1. Western Balkan countries⁴: Attracting financing on the way to EU accession

The EU accession process has brought about new economic institutional ties between the EU and the Western Balkan countries, such as the Stabilization and Association Agreement (SAA). The SAAs replaced a number of interim agreements with the EU on trade and trade-related issues and were progressively negotiated with all Western Balkan countries and entered into force in the period 2004-2016⁵. The SAAs envisage the facilitation and deepening of trade flows between the region and the EU, in conformity with GATT 1994 and WTO⁶, through preferential trade regimes. It aims to stabilize the countries, encourage their swift transition to market economies and promote regional cooperation. The Instrument for pre-accession (IPA) has a budget of EUR 11.7 billion for the period 2014-2020 (Dursun-Ozkanca, 2016). In addition, for the EU financing period (2021-2027), the EU Commission has proposed an increase of the IPA budget to EUR 14.5 billion.

In February 2018, the European Commission adopted a strategy for '[A credible enlargement perspective for and enhanced EU engagement with the Western Balkans](#)', to commit to a “geostrategic investment in a stable, strong and united Europe based on common values”⁷. The strategy clearly spells out that the EU door is open to further accessions as long as the individual countries have met the criteria. Among the target countries, Montenegro and Serbia are considered closest to completing the accession process with accession talks already under way. The strategy foresees an Action Plan with six concrete flagship initiatives, which concern specific areas of common interest: rule of law, security and migration, socio-economic development, transport and energy connectivity, digital agenda, reconciliation and good neighborly relations. Concrete actions are planned to be carried out between 2018 and 2020. Under the strategy, the European Commission plans to gradually increase funding under the Instrument for Pre-Accession Assistance (IPA) until 2020. In 2018 alone, pre-accession assistance for the Western Balkans was to reach EUR 1.07 billion. EUR 9 billion have been disbursed in the 2007-2017 period (EWB, 2018). Recent estimations point towards EU financial assistance of up to 4% of GDP per annum in the period 2009-2017, the majority of which was grants (Grievson et al., 2018).

The 2014 High Level Conference on the Western Balkans in Berlin, under the leadership of the German Chancellor Angela Merkel, was another milestone in that respect. The conference built the starting point of what was then called the “Berlin process” and aimed to show the firm political commitment of the EU to a future enlargement towards the WB. With a proper agenda - known as the “Berlin Agenda” – more progress was to be achieved on economic governance as well as infrastructure connectivity projects, using existing financing programs such as Western Balkans Investments Framework. The 2014 conference was followed by the [2015 Vienna Summit](#), the [2016 Paris Summit](#), the 2017 [Trieste](#) summit and the London summit in July 2018.

In spite of the sizable EU IPA-funded investments in the process of EU accession, a sizable financing gap persists (Radzyner et al. 2011). Assessment of Grievson et al. (2018) point towards an

⁴ The Western Balkans comprise the EU candidate countries Albania (AL), the Former Yugoslav Republic of Macedonia (FyROM), Montenegro (MNE) and Serbia as well as the potential candidate countries Bosnia and Herzegovina, and Kosovo. The designation “Kosovo” is used without prejudice to positions on status and in line with UNSC 1244 and the opinion on the Kosovo Declaration of Independence.

⁵ The respective SAAs entered into force in the following years: Albania – 2009; Bosnia and Herzegovina – 2015; the former Yugoslav Republic of Macedonia – 2004; Kosovo – 2016; Montenegro – 2010; Serbia – 2013.

⁶ Albania joined the WTO on 8 September 2000, the former Yugoslav Republic of Macedonia on 4 April 2003, and Montenegro on 29 April 2012. Bosnia and Herzegovina, Kosovo and Serbia are not yet members of the organisation.

⁷ EC (2018) Strategy for the Western Balkans, 6 Feb 2018, https://ec.europa.eu/commission/news/strategy-western-balkans-2018-feb-06_en

investment gap of up to 12% of GDP per year in the period 2018-2022 in the Western Balkans. As these countries cannot access large EU cohesion and structural funds until they join the EU, their economic ties with large emerging players and investors China, Turkey and Russia have gained in importance. In addition, disillusionment with the EU accession process among the population is substantial. In fact, the Balkan Opinion Barometer shows that in 2018 on average, in the Western Balkan countries, 26% of survey participants answered “never” to the questions “In general, when do you expect the accession of your country to the EU to happen?”, which is roughly at the same level as the past couple of years. At the same time, the share of undecided respondents has almost doubled⁸.

Western Balkan countries have become the center of attention recently, when it comes to connecting China to the EU and its internal market through the Belt Road Initiative (BRI) along the ancient Silk Road. Historically however, it were Russia and Turkey who kept one foot in the camp, be it through political influence or energy deals, notwithstanding the ongoing EU accession processes. Compared to the relatively slow process of project preparation and other institutional obstacles when applying for EU funding, particularly Chinese investments appear as a competitive alternative as they come with streamlined approval processes, state-backed financing, and rapid implementation (Sanfey et al. 2016).

2. Building institutional ties in the Western Balkans

2.1. Turkey: rethinking its Western Balkan strategy in light of own gloomy EU accession prospects

Turkey’s historical and cultural ties with the Western Balkan countries date back to the legacy of the Ottoman Empire which left its traces not merely in the cultural and religious-ethnic mix of the population, and more recently to the Turkey’s active role in building stability in the region in the 1990s (i.a. through the NATO, the Southeast European Cooperative Initiative, Stability Pact, South-East European Initiative., see e.g. Dursun-Ozkanca, 2016). In economic terms, Turkey has the advantages of geographical proximity, which allows for a reduction in transportation costs, as well as an existing similarity in consumption habits. Consequently, Turkey has signed free bilateral trade agreements with Albania (2008⁹), Bosnia and Herzegovina (2003)¹⁰, Kosovo¹¹, FYROM¹², Montenegro (2010¹³) and Serbia (2009¹⁴).

Turkey itself has applied for EU candidacy in 1987 and has entered negotiations in 2005 and therefore knows the challenges the accession process entails. At the onset, Turkey was enthusiastic about joining the EU. It therefore framed its Balkan policies in a way to demonstrate its own strategic value to Europe (Krastev, 2018). With the current political situation in Turkey, President Erdogan’s anti-European stance and the growing rhetoric in Europe of stopping negotiation processes, the relationship between the EU and Turkey is currently at a low although some slight improvement could be seen in the aftermath of the onset of the currency crisis in August 2018. It may thus well be that

⁸ See Balkan Opinion Barometer, Regional Cooperation council, “EU membership”:
<https://www.rcc.int/seeds/results/2/balkan-opinion-barometer>

⁹ Investment policy hub website: <http://investmentpolicyhub.unctad.org/IIA/treaty/3392>

¹⁰ Investment policy hub website: <http://investmentpolicyhub.unctad.org/IIA/treaty/3310>

¹¹ Export.gov website: <https://www.export.gov/article?id=Kosovo-Trade-Agreements>

¹² Export.gov website: <https://www.export.gov/article?id=Macedonia-Trade-Agreements>

¹³ Export.gov website: <https://www.export.gov/article?id=Montenegro-Trade-Agreements>

¹⁴ Balkan Insight (2017)

Turkey builds more actively upon its soft power in the Western Balkans to strengthen its economic influence. Some observers speak of “Neo-Ottomanism”, referring to the possibility for Turkey to use the religious and cultural proximity with large parts of the population in the region (see: Ducourtieux, Stroobants, 2018; Dursun-Ozkanca, 2016).

According to recent analyses (i.a. Dursun-Ozkanca, 2016), Western Balkan leaders could react in two different ways. If EU accession does not progress as smoothly as they would hope for, Western Balkan governments could turn towards Turkey and away from the EU. On the other hand, Western Balkan leaders could refrain from giving the EU the impression that they are close to Turkey, in order not to challenge their own accession perspective. In recent years, some Western Balkan governments have shown their support to the Turkish government, whether related to Turkey’s role in controlling refugee traffic to Europe or prohibiting organizations opposed to the current Turkish government after the coup attempt of July 2016 (Ekinci, M.U., 2017).

2.2. Russia: leaving a foot in the doorway

Similarly to Turkey, Russia has a strong cultural and historical affinity with the Western Balkan countries. To some extent similar to the Turkish “soft” influence, Russia therefore also has a way to apply soft power in the region (Bechev, 2015). Only three Western Balkans countries have so far closed bilateral trade agreements with Russia, namely Albania (Trade and Economic Cooperation Agreements; Treaty for the Avoidance of Double Taxation¹⁵), Bosnia and Herzegovina (trade and economic cooperation agreements¹⁶), and Serbia (bilateral free trade agreement¹⁷), while a trade agreement with Montenegro is currently under negotiation¹⁸.

Russia’s economic relations with the Western Balkan countries have weakened in the last years. Russia’s share in the region’s foreign trade and investment has been decreasing for several years, falling from one of the region’s top economic partners at the beginning of the century to single digits today (see Chart 1). In general, Russian businesses are mainly concentrated on a few sectors, namely banking, metallurgy, real estate and, since the late 1990s, energy. The figures shrunk or stagnated even further in the light of the international sanctions imposed because of the annexation of Crimea (Samorukov, 2017; Bechev, 2015; Vladimirov et al, 2018)¹⁹.

Only in the energy sector, the Kremlin has considerable influence particularly in Serbia, Bosnia and Herzegovina, and FYR Macedonia, where crude oil and natural gas comprise between 75 and 95 percent of imports from Russia. Energy dependence has contributed to the countries’ overall trade vulnerability, although its influence has generally declined in the past decade. In Serbia, Russia has “taken advantage of ineffective governance in key sectors of the economy to expand its footprint”, as its investments in the energy sector are designed to reduce competition and reinforce Russia’s position by locking in supply (Vladimirov et al, 2018). Serbia is heavily reliant on energy exports from Russia, which ties the two countries together in a way that other commodities do not (see also Hardwell & Sidlo, 2017). The same is true for Bosnia and Herzegovina as the country is fully dependent on Russian energy imports. Natural gas covers around 25 percent of the needs of the central heating utilities (the rest comes from fuel oil) but is otherwise insignificant for the country’s energy sector. Despite its insignificance, Bosnia and Herzegovina and FYR Macedonia allegedly pay some of the

¹⁵ Invest in Albania website: <https://invest-in-albania.org/trade-agreements>

¹⁶ Embassy of Bosnia and Herzegovina website, <https://rf-bih.ru/en/bilateral-relations/agreements-between-bosnia-and-herzegovina-and-russian-federation/>

¹⁷ Export.gov website: <https://www.export.gov/article?id=Serbia-Trade-Agreements>

¹⁸ Export.gov website: <https://www.export.gov/article?id=Montenegro-Trade-Agreements>

¹⁹ While Albania and Montenegro joined EU sanctions against Russia imposed as from March 2014 onwards, Serbia and FYR Macedonia decisively opposed such a move so far.

highest import prices for gas in Europe; respectively USD 515/1,000 cubic meters and USD 564/1,000 cubic meters in 2013 (Vladimirov et al, 2018).

Still, politicians and certain business leaders publicly defend these large-scale projects allegedly without proper cost-benefit analysis. As these often largely loss-making companies typically do not pay corporate taxes and fail to create new jobs, these deals often result in fiscal and socio-economic vulnerabilities (Vladimirov et al, 2018). According to reports, Gazprom for instance has solidified its dominance over the domestic natural gas markets in Bosnia and Herzegovina, FYR Macedonia and Serbia by striking inflexible long-term gas supply agreements; promoting large-scale, expensive gas pipelines; installing domestic gas intermediaries with strong political connections; and blocking attempts at liberalization of the market. Yet, instead of seeking to diversify their gas supplies through natural gas interconnectors with Bulgaria and Croatia, the Western Balkan countries (except for Montenegro, which does not consume much gas) continue to promote Russian-led gas infrastructure projects (e.g. Gazprom, South Stream and TESLA) (Vladimirov et al, 2018).

The future influence of Russia in the Western Balkan region is open. To Russia, the Western Balkans have established themselves as “a transit region for its energy exports to Western European markets” and the sentiment is rather towards a preservation of the degree of influence rather than a competition with Brussels (Krastev, 2018). On the international political scene, Russia is seen as a tactical player taking swift decisions and acting flexibly (Bechev, 2015).

2.3. China: quick and easy financial injections

Unlike Russia or Turkey, China does not have any longstanding historical or cultural and ethnical ties with most Western Balkan countries. Nevertheless, China²⁰ is without any doubt a rising force in the region and its economic influence should not be ignored as the financial and economic links between China and the Western Balkan countries have intensified significantly since 2015.

Geographically, the Western Balkans (and Greece) constitute the final part of China’s new Maritime Silk Road. In view of extending the New Silk Road (NSR) into the Balkans, China primarily invests in regional infrastructure, such as ports, railroads and highways, mainly through the so-called “16+1 format” which includes Albania, Bosnia and Herzegovina, FYR Macedonia, Montenegro and Serbia. Since 2015, the 16+1 format also introduced an investment fund of USD 10 billion to finance various projects in Central Eastern and South-Eastern Europe (CESEE). The cooperation under this format is being increasingly institutionalized, not least through the planned introduction of a permanent business council and the planned signing of a number of high-profile bilateral memoranda of understanding (Barisitz and Radzyner, 2017).

This strategy relies on the assumption that the Western Balkan countries will considerably catch up, integrate into the EU and thereby build a bridge for Chinese companies to the main EU markets. Along these lines, the purchasing power in the Western Balkan countries will increase. Also, as the gap in labor costs between China and the Western Balkan countries would narrow too, Chinese manufacturers may find it cheaper to locate their production facilities closer to their destination markets in the EU. Politically, Chinese investors show more readiness to get involved in countries with higher political instability, and to take up the role of a neutral force and a reliable business partner. Anecdotal evidence shows, that Chinese investors however often bypass EU trade laws if it is possible. The spillovers of the large investments into the local economies is yet unknown, given that Chinese companies generally employ their own resources, including workers, without respecting national or local labor laws (Barisitz and Radzyner, 2017).

Bilateral trade agreements have been closed with Albania, Montenegro (taxation treaty) and Serbia. The latter signed a strategic partnership agreement with China in 2009, laying the formal basis

²⁰ As of 2019, China has still not recognized Kosovo as an independent country.

for a large number of infrastructure, energy, car manufacture and other projects. It allows Chinese companies to participate in Serbia's planned privatization process, in which more than 500 companies (in particular, the national railway company) are listed for a sell-off. This partnership offers access to a free trade area of around 550 million potential consumers via free trade agreements that Serbia has concluded with the EU, the CEFTA and the European Free Trade Association (EFTA). Institutional links were forged between the Belgrade Chamber of Commerce and the Beijing Investment Promotion Bureau in late 2016, and an 'Association of Chinese Businesspeople in Serbia' was created in 2015. There has also been talk of two free trade zones (in *Obrenovac* and *Palilula*) as a way to attract Chinese companies²¹ (Hardwell & Sidlo, 2017).

Compared to Turkey or Russia, China was not even a topic slightly over a decade ago. Now, China is among the top investors in some Western Balkan countries (i.e. in terms of investment flows) and ranks number one foreign investor in Serbia (Krastev, 2018). When looking at the activities carried out under the 16+1 cooperation framework i.a. in education, culture, research and development, it becomes clear that the Belt and Road Initiative goes beyond mere economic investments. This shows that China is progressively building up the "soft power" that Russia and Turkey had forged through their longstanding relationship with the region.

3. A brief take on the economic exposure of the Western Balkans to China, Russia and Turkey

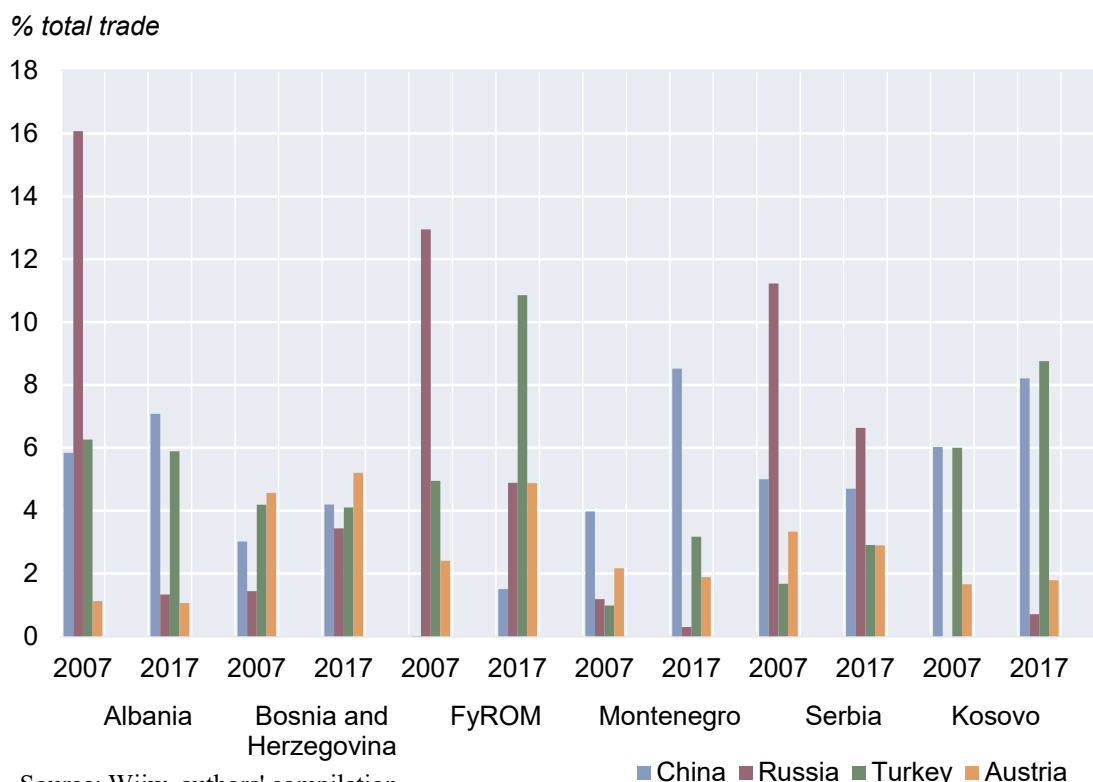
Although the European Union remains the major trade partner of all Western Balkan economies, trade openness of the Western Balkan economies vis-à-vis Turkey has increased in all countries in the past ten years (see Chart 1). Accordingly, the share of trade with the EU amounts to up to 70% in FYR Macedonia and Bosnia and Herzegovina. In 2017, the share in total trade between the Western Balkan countries and Turkey was the highest in Kosovo (8.8%) and was the lowest in Serbia (2.9 %). Interestingly, trade exposure to Austria and Turkey stays on roughly the same level in the largest economies in the region - Bosnia and Herzegovina and Serbia. While imports of Turkish goods prevail trade, especially Serbian goods exports to Turkey increased sizably recently to reach one-third of total trade with Turkey.

Trade with Russia is comparably less important for most of the EU (potential) candidate countries (EU PCC) especially for Kosovo, Albania and Montenegro. On the contrary, Russia has been among the top three trade partners for Serbia in the past years. In addition, Serbian exports to Russia have continuously increased since 2007 with exports coming up to 34% of total trade with Russia in 2016.

²¹ Belgrade-Beijing cooperation: Chinese entrepreneurs interested in PKB 2016

<https://www.serbianmonitor.com/en/belgrade-beijing-cooperation-chinese-entrepreneurs-interested-pkb/>

Chart 1: Trade exposure of the Western Balkan countries to selected countries



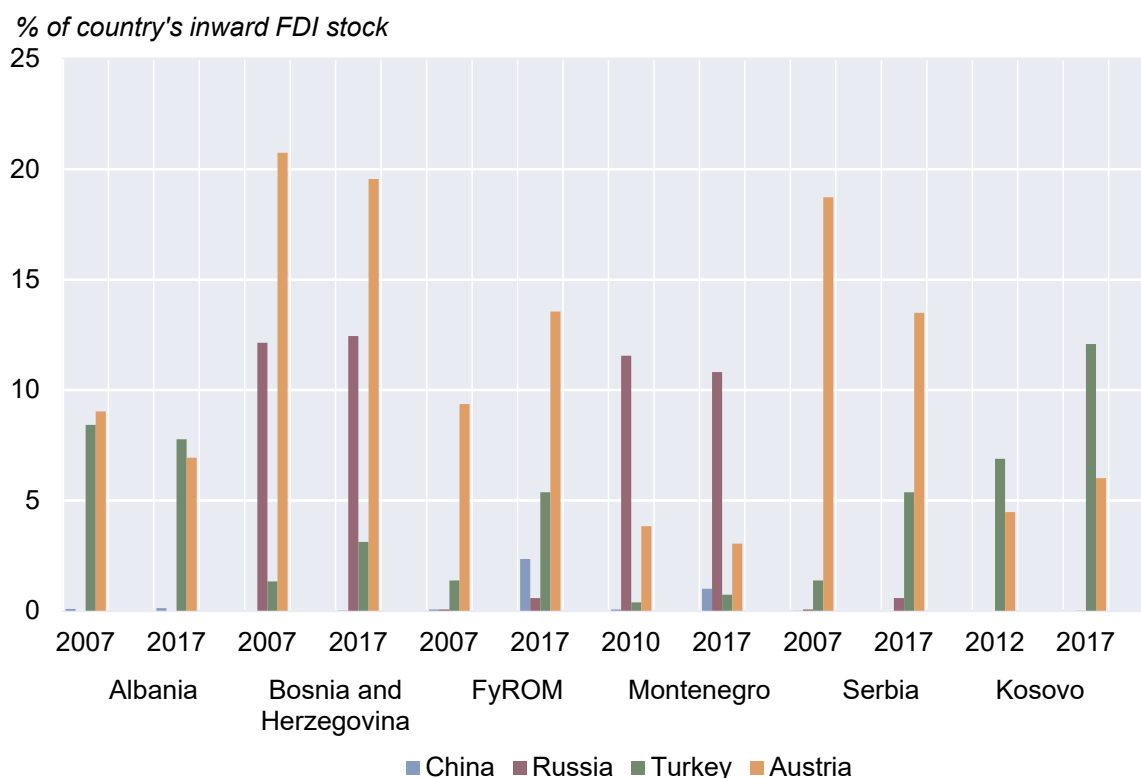
Source: Wiiw, authors' compilation.

Note: Data consist of the sum of exports and imports of goods.

In the Western Balkan region, China has set up bilateral agreements with Albania, Montenegro (taxation treaty) and Serbia. Accordingly, trade with goods with China has been the highest from the three countries and is also on an increasing trend in all Western Balkan countries. Only in Albania and Montenegro, it stood at 7% and 9% of total trade in 2017, respectively.

Despite the funding available from EU sources and International Financial Institutions (e.g. Western Balkans Investment Framework) financing needs of the Western Balkan countries remain substantial. Non-EU firms' investments therefore benefit the Western Balkan countries, which cannot access large EU structural funds but are in need of financing to make progress toward EU accession. Turkish investment stocks in Albania and Kosovo rank among the highest surpassing Austrian FDI stocks by a significant margin (see Chart 2). Turkish FDIs have more than quadrupled since 2007 in Serbia and FYR Macedonia and have targeted predominantly the construction, infrastructure and manufacturing sectors. In addition, Turkish-owned banks are among the largest banks in Albania, Kosovo and FYR Macedonia taking up currently close to one third of total banking assets in Albania.

Chart 2: Inward Foreign Direct Investment (FDI) stock of selected countries to the Western Balkan countries



Source: Wiiw, authors' compilation.

Russian FDI stocks²² are rather low in the majority of the Western Balkan countries except in Bosnia and Herzegovina and Montenegro. Russian investments are mainly focused on key sectors such as energy, banking and real estate. In particular, Russia has been the largest investor in Montenegro with investments primarily in real estate and tourism sectors. Total Russian investment in the country stood at slightly above 11% of GDP in 2017. In addition, also the exposure to Serbia and FYR Macedonia has steadily increased since 2007²³.

The financial and economic links between China and the Western Balkan countries have intensified significantly since 2015. According to conventional FDI metrics, China does not hold sizable FDI stocks in the Western Balkan countries yet. The FDI statistics, however, underestimate Chinese involvement in the region as in many cases it is structured as debt financing of large infrastructure projects in the transport and energy sectors (Kaloyanchev et al, 2018). State-owned Chinese banks such as Exim Bank usually finance 85% of the NSR/BRI projects, thus 15% have to be co-financed through national sources. Particularly in smaller countries, sceptics fear that this will result in indebtedness and consequently higher economic and political dependence on China in the future (at least until investments pay off in the long term) (Bastian, 2017).

22 For the sake of completeness, discussion on the Russian exposure in the Western Balkans should include information also on loans granted to state entities. Although these have been sizable in some of the countries in the recent years, this would go beyond the scope of this Box.

23 Anecdotal evidence points toward a strong underestimation of Russian FDI stocks in FYR Macedonia and Serbia due to channelling Russian investments via EU countries with a preferential tax system (e.g. Cyprus, Netherlands).

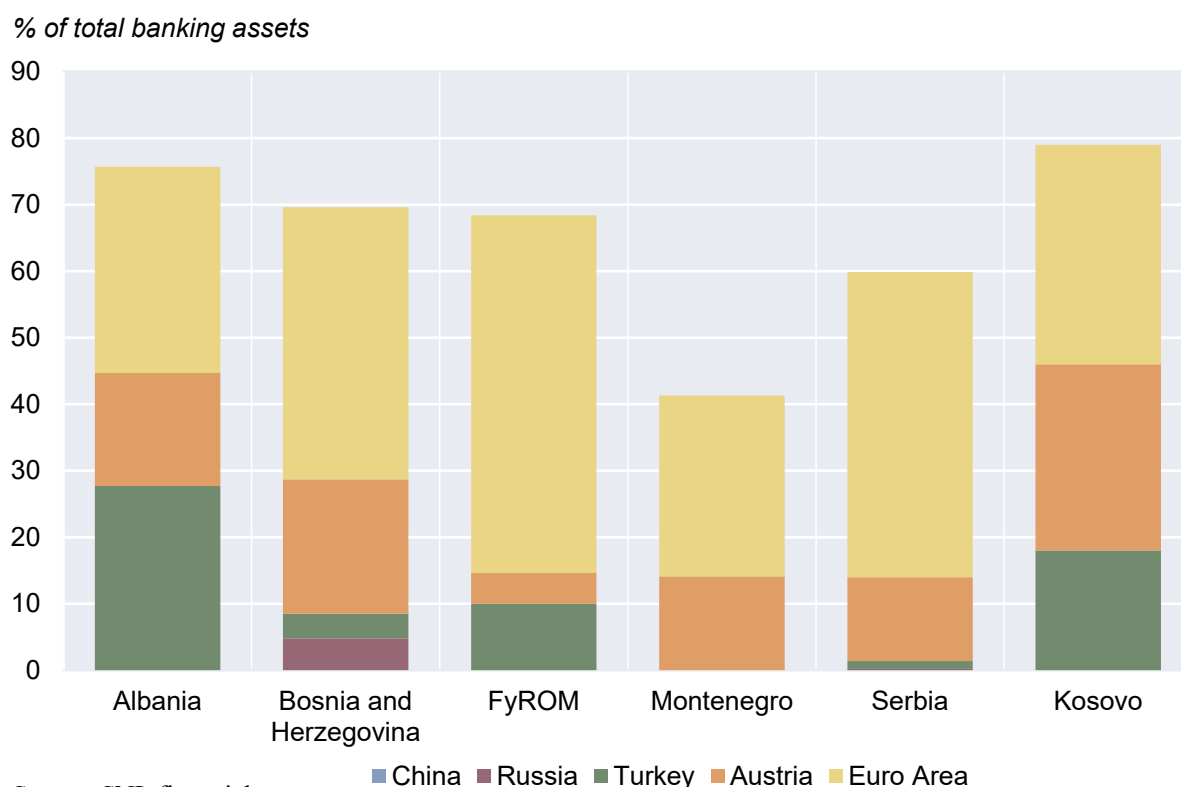
4. Banking sectors in the Western Balkans: the economic ties that bind

The banking sectors in the Western Balkans remain dominated by foreign-owned banks with an average of 90% of total banking assets. Banks with headquarters in the Euro Area countries, mainly Austria, Italy, Germany and France, amount to up to 60% of all total banking assets (Raiffeisen, 2018). While foreign ownership is prevalent, domestically owned banks come to almost 25% of total banking assets in Serbia, Montenegro and Albania in 2017. Until recently Montenegro was the only country in the Western Balkan region with no participation of the three countries (i.e Turkey, China, Russia) as investors on the banking markets (IMF, 2015). In 2015, a Turkish bank, *Ziraat bankasi*, has been granted a license for operation, however, its market share has so far remained negligible.

Turkey has emerged as a major investor in Kosovo and Albania, where currently in the latter country *Banka Kombëtare Tregtare* is the largest bank, owing 28% of the banking assets. Banks from the Euro Area come to 44% of total banking assets, Raiffeisen bank being one of the largest with a market share of 17% in Albania as of start-2018. In Kosovo, three out of eight banks with foreign ownership are Turkish with a cumulative market share of 16% as of mid-2017 (Central Bank of the Republic of Kosovo, 2017). In the largest banking markets in the region - Serbia and Bosnia and Herzegovina - Turkey has a marginal position with only one bank, respectively being represented (Chart 3).

Russian investment in the banking sectors in the Western Balkans is still small but has been on the increase in the past years (Vladimirov et al., 2018). So far, Russian banks operate only in Bosnia and Herzegovina and Serbia. Allegedly, on the back of a relative “aggressive” market strategy, Russian banks (i.e *Sberbank*) have expanded swiftly in Bosnia and Herzegovina (IMF, 2016), coming close to 7% of total banking assets in 2014. *Sberbank* is also among the top three banks in Republika Srpska of Bosnia and Herzegovina. Since its entering the banking market in Serbia in 2012, *Sberbank* has not significantly increased its market share, and maintains the relatively low profitability of its Austrian predecessor (i.e *Volksbank International AG*).

Chart 3: Ownership of banking sector assets in the Western Balkan countries



Source: SNL financials.

Note: Data refer to end-2017. Euro area banking assets exclude Austria.

Chinese participation in the banking market in the Western Balkan countries is still limited to the state-owned Exim Bank opening its first subsidiary in Serbia in 2016 (market share of less than 1% of total banking assets in 2017). Overall, Chinese banks currently do not target the retail market but lend funds directly to the governments for investments in infrastructure, highways and railroads (e.g. in Serbia, Montenegro, FYR Macedonia) or energy and utility sectors (e.g. in Bosnia and Herzegovina and Serbia). Typically, loans from Chinese banks are concessional loans, provided for 20 to 30 years with a 2 to 3 percent interest rate (Barisitz and Radzyner, 2017).

5. Conclusions

As the EU is discussing its future strategies on whether to deepen or to enlarge, and a trade war between the USA and China is the “talk of the town”, EU accession prospects of Western Balkan countries are moving slowly. Only recently, EU High Representative Mogherini reiterated the EU’s commitment to continue negotiations with Montenegro and Albania in the context of the Annual Report on country accession 2018. Still, as general disillusionment with the EU is sizable, Western Balkan leaders are caught in a balancing act between EU accession (requiring them to move much closer to the EU in their foreign policy), the solutions offered by quick and simple investments from China and the steady helping hands of Turkey and Russia.

Turkey and Russia have more long-standing historical, political and economic ties with the Western Balkan countries. Turkey’s strategy in the Western Balkans could change as its relationship with the EU turns away from accession, by building more actively upon its soft power (cultural and

religious ties) in the region to strengthen its economic influence. Western Balkan leaders could, if EU accession does not speed up, turn towards Turkey and away from the EU or, on the contrary, refrain from giving the EU the impression that they are close to Turkey. As to Russia, with growing disillusionment of the Western Balkan with the West, leaders may consider turning east. Even if Moscow has no desire to take on Western Balkan economic or security problems, it is ready to give that impression.

Both economic and financial sector exposure to China, Turkey and Russia are lower than to the EU countries. However, the economic dependency on these three countries is on the rise in all Western Balkan countries. The largest economies in the region - Bosnia and Herzegovina, Serbia and FYR Macedonia - are strongly interlinked with Russia, in trade, especially due to the energy imports, and less so in the banking sectors. Russian FDI are key in Montenegro and Bosnia and Herzegovina. In economic terms, Turkey is particularly relevant for Albania, Kosovo and FYR Macedonia, where a Turkish banks rank among the first. In Serbia, the biggest economy in the region, Turkish investments have been also on the increase recently. To most Western Balkan countries, China was not even on the political landscape a decade ago. Now, China not only ranks among the top economic investors in some Western Balkan countries, but it also builds up its “soft power” by implementing increasingly more educational, cultural and research-oriented projects in the region. The size of investments is considerable, and as projects are implemented quickly and with no bureaucratic hurdles, Western Balkan leaders may also turn towards China instead of focusing their strategy on an uncertain European future.

For the EU, the consequences are manifold. First, it needs to thoroughly follow its Western Balkan strategy and give Western Balkan governments a sense of certainty about a future accession. Second, the EU and China need to find trade arrangements that benefit all parties involved. Third, a good relationship between the EU and Russia is key, as Russia can easily build upon its prevailing influence in the region. Lastly, Turkey’s relationship with the EU is very fragile given President Erdogan’s rhetoric in Europe of stopping negotiation processes. It could be understood that Turkey and Russia coordinate their Western Balkan strategy, leave the EU in a blind spot. As such, it is certainly up to the EU to act in a coordinated strategic manner to leave no doubts to the Western Balkan countries about their foreign policy choices.

References

- Balkan Insight (2017)**, Serbia, Turkey Sign Agreements to Boost Trade, 10/10/2017, <http://www.balkaninsight.com/en/article/serbia-turkey-sign-agreements-to-boost-trade-10-11-2017>
- Barisitz, S. and Radzyner, A. (2017)**, The New Silk Road, part II: implications for Europe. Focus on European Economic Integration Q4/17, OeNB, December 2017, <https://www.oenb.at/Publikationen/Volkswirtschaft/Focus-on-European-Economic-Integration.html>
- Bastian, J. (2017)**, The potential for growth through Chinese infrastructure investments in Central and South-Eastern Europe along the “Balkan Silk Road”, European Bank for Reconstruction and Development (EBRD), July.
- Bechev, D. (2015)**, Russia in the Balkans. Conference report. 13.03.2015 <http://www.lse.ac.uk/LSEE-Research-on-South-Eastern-Europe/Assets/Documents/Events/Conferences-Symposia-Programmes-and-Agendas/2015-Report-Russia-in-the-Balkans-merged-document.pdf>
- Central Bank of the Republic of Kosovo (2017)**, Financial Stability Report 11.
- Ducourtieux, C. and Stroobants, J.-P. (2018)**, Balkans. L’UE face au dilemme de l’élargissement, Le Monde, 18.-19.2.2018.
- Dursun-Ozkanca, O. (2016)**, Turkish Foreign Policy and the Balkans: Implications on Transatlantic Security, LSE, January.
- Ekinci, M. U. (2017)**, Turkey and the Western Balkans: Stable Relations and Deepening Cooperation. Transatlantic Relations. November. <https://transatlanticrelations.org/wp-content/uploads/2017/11/ch11.pdf> (last accessed 11.05.2018)
- European Commission (2018)**, Strategy for the Western Balkans, 6 Feb 2018, https://ec.europa.eu/commission/news/strategy-western-balkans-2018-feb-06_en
- EWB – European Western Balkans (2018)**, Strategy for the Western Balkans: EU sets out new flagship initiatives and support for the reform-driven region, 06.02.2018. <https://europeanwesternbalkans.com/2018/02/06/strategy-western-balkans-eu-sets-new-flagship-initiatives-support-reform-driven-region/>
- Grievson, R., Gruebler, J. and Holzner, M. (2018)**, Western Balkans EU Accession: Is the 2025 Target Date Realistic?, Policy Notes and Reports 22, The Vienna Institute for International Economic Studies.
- Hardwell, C. and Sidlo, A. (2017)**, Serbia’s cooperation with China, the European Union and the United States of America, CASE – Center for Social and Economic Research commissioned by the European Parliament, Dec. 2017.
- IMF (2015)**, Montenegro: Financial Sector Assessment Program, IMF Country Report No. 16/198.

IMF (2016), Bosnia and Herzegovina: Financial Sector Assessment Program, IMF Country Report No. 15/214.

Kaloyanchev, P., Kusen, I. and Mouzakitism A. (2018), Untapped Potential: Intra-Regional Trade in the Western Balkans, DG ECFIN Discussion Paper, forthcoming.

Krastev, I. (2018), Europe is facing a potential crisis in the Balkans. It has to act soon. The Guardian, 21/02/2018

Radzyner, A., Schneidewind, P., Hahn, M., (2011). Analysis of needs for financial instruments in the EU Strategy for the Danube Region (EUSDR), Metis GmbH, http://www.danube-region.eu/images/olddocs/FinalReport_09_01_2012.pdf (last accessed in Feb. 2017)

Raiffeisen (2018), EU Enlargement to the Western Balkans- Dimensions and Strategic Aspects
Samorukov, M. (2017), Russia's Tactics in the Western Balkans, Carnegie Europe, 3/11/2017, <http://carnegieeurope.eu/strategieurope/74612>

Sanfey, P., Milatovic, J., Kresic, A. (2016). How the Western Balkans can catch up, European Bank for Reconstruction and Development, 19/02/2016, <http://www.ebrd.com/news/2016/how-the-western-balkans-can-catch-up.html> (last accessed in Feb. 2017)

Vladimirov, M., Kovačević, M., Mirjagic, M., Novakovic, I., Štiplija, N., Nuredinoska, E., Dimiškova, S. (2018), Assessing Russia's Economic Footprint in the Western Balkans. Corruption and State Capture Risks. Center for the Study of Democracy, Sofia.

Websites:

- Balkan Opinion Barometer, Regional Cooperation council, "EU membership": <https://www.rcc.int/seeds/results/2/balkan-opinion-barometer>
- Investment policy hub website: <https://investmentpolicyhub.unctad.org/>
- European Commission: https://ec.europa.eu/commission/publications/enhancing-eu-engagement-western-balkans_en
- Export.gov website: <https://www.export.gov/article?id=Kosovo-Trade-Agreements>
- Invest in Albania website: <https://invest-in-albania.org>
- Embassy of Bosnia and Herzegovina website: <https://rf-bih.ru/en>

Annex

Box – EU accession status of the Western Balkan countries

Albania applied for the EU membership in April 2009 and received the candidate status in June 2014. In April 2018, the European Commission recommended to the Council to decide that the accession negotiations be opened in light of progress achieved.

The **former Yugoslav Republic of Macedonia** was declared a candidate country in December 2005. In April 2018, the European Commission recommended to the Council to decide that the accession negotiations be opened in light of progress achieved. In the 2018 Progress Report of the European Commission was underlined that the "name issue" with Greece needs to be resolved as a matter of urgency. Currently, some progress hereto has been achieved (e.g a joint announcement by the Prime Ministers of Greece and the former Yugoslav Republic of Macedonia in January 2018, the renaming of Skopje airport and a highway and proceeding with some delayed EU initiatives).

Montenegro submitted the application for EU membership in December 2008. The candidate status was granted on 17 December 2010. The opening of accession negotiations took place in June 2012. After five years of accession negotiations, by December 2017, 30 out of 35 negotiating chapters had been opened, of which three are provisionally closed.

Serbia applied for the candidate country status in December 2009. The candidate country status was granted in March 2012. On 21 January 2014, the first Intergovernmental Conference took place, signaling the formal start of Serbia's accession negotiations. By December 2017, 12 chapters out of 35 had been opened of which two were provisionally closed.

Stabilisation and Association Agreement (SAA) negotiations with **Bosnia and Herzegovina** were opened in September 2005 and on 16 June 2008, Bosnia-Herzegovina and the European Union signed the Stabilisation and Association Agreement. The SAA entered into force in June 2015. In February 2016, Bosnia and Herzegovina submitted its application to join the EU. In December 2016, Commissioner Hahn hands over to Bosnia and Herzegovina authorities the Commission's Opinion Questionnaire. In February 2018, Bosnia and Herzegovina authorities deliver to President Juncker and Commissioner Hahn the answers to the Questionnaire. .

Kosovo's authorities declared independence on 17 February 2008. The European Union took note of the declaration of independence, left to the Member States to decide on the recognition and asked the Commission to enhance the cooperation with Kosovo. The Stabilization and Association Agreement between EU and Kosovo has been initiated in July 2014 and entered into force in April 2016. In May 2016, the European Commission proposed visa-free travel for the people of Kosovo. In October 2016, the first meeting of the EU Kosovo Stabilisation and Association Council took place.

Source: European Commission website, Enhancing EU engagement with the Western Balkans, December 2018.

- 2015 No 1 Alexey Kudrin and Evsey Gurvich: A new growth model for the Russian economy
No 2 Heli Simola: Venäjän valuuttavaranto ja rahastot
No 3 Stephan Barisitz and Zuzana Fungáčová: Ukraine: Struggling banking sector and substantial political and economic uncertainty
No 4 Heli Simola: Russia's international reserves and oil funds
No 5 K.C. Fung, Alicia Garcia-Herrero and Jesus Seade: Beyond minerals: China-Latin American Trans-Pacific supply chain
No 6 Anni Norring: Suomen ja Venäjän välisten suorien sijoitusten tilastot
No 7 Vesa Korhonen, Zuzana Fungáčová, Laura Solanko, Iikka Korhonen ja Heli Simola: BOFIT Venäjä-tietoisku 2015
No 8 Yang Yao: When are fixed exchange rates an appropriate policy tool for growth?
No 9 Heli Simola: Rebalancing of demand in China – illustrating possible effects with an input-output analysis
No 10 Iikka Korhonen: How fast can Russia grow?
No 11 Jouko Rautava, Riikka Nuutilainen, Anni Norring, Iikka Korhonen ja Jyrki Kallio: BOFIT Kiina-tietoisku 2015
- 2016 No 1 Riku Niemi: The Eurasian Union – much potential, little results
No 2 Andrei Yakovlev: What is Russia trying to defend?
No 3 Andrei Yakovlev, Lev Freinkman and Anton Zolotov: Domestic and external factors in the development of Russia's economic think tanks sector
No 4 Mikko Mäkinen: Nowcasting of Russian GDP growth
No 5 Iikka Korhonen, Tuomas Forsberg, Vesa Korhonen ja Heli Simola: BOFIT Venäjä-tietoisku 2016
No 6 Heli Simola: Economic relations between Russia and China – Increasing inter-dependency?
No 7 Ivan Lyubimov: Are educational reforms necessarily growth-enhancing? Weak institutions as the cause of policy failure
No 8 Laura Solanko: Opening up or closing the door for foreign trade – Russia and China compared
No 9 Heli Simola ja Vesa Korhonen: Arktisen alueen taloudellinen merkitys Venäjälle
No 10 Masaaki Kuboniwa: Estimating GDP and foreign rents of the oil and gas sector in the USSR then and Russia now
No 11 Masaaki Kuboniwa: Considerations on new Rosstat data on the contribution of Russia's military goods sector to GDP growth in recent years
- 2017 No 1 Jouko Rautava: Kiinassa talouspolitiikka ei pysy maan muutosten vauhdissa
No 2 Heli Simola: China's growing role in global production boosted by strong competitiveness – evidence from international input-output tables
No 3 Heli Simola ja Laura Solanko: Katsaus Venäjän öljy- ja kaasusektoriin
No 4 Heli Simola: Chinese production chains rely increasingly on domestic services
No 5 Heli Simola and Laura Solanko: Overview of Russia's oil and gas sector
No 6 K.C. Fung, Nathalie Aminian, Iikka Korhonen and Keith Wong: The Chinese yuan: Influence of interest groups examined
No 7 Päivi Määttä: Meeting the challenges of impact measurement
No 8 Caroline Stern, Mikko Mäkinen and Zongxin Qian: FinTechs in China – with a special focus on peer to peer lending
No 9 Iikka Korhonen and Riikka Nuutilainen: Breaking monetary policy rules in Russia
No 10 Andrei Yakovlev, Lev Freinkman, Sergey Makarov and Victor Pogodaev: In response to external shocks: How advanced Russian regions react to changes in federal policies – Experience of Tatarstan
- 2018 No 1 Ivan Lyubimov and Maria Lysyuk: Schooling ain't learning in Russia either: High level of student employment as an indicator for slow human capital accumulation
No 2 Jouko Rautava: Intian nopea kasvu ei vähennä reformien tarvetta
No 3 Eeva Kerola: Hongkongin talous on vahvasti kytkeytynyt Manner-Kiinaan
No 4 Iikka Korhonen, Heli Simola and Laura Solanko: Sanctions, counter-sanctions and Russia – Effects on economy, trade and finance
No 5 Andrei Yakovlev, Lev Freinkman and Nina Ershova: Channels of dialogue between international businesses and national governments: The implications for domestic reforms and international relations in the case of Russia
No 6 Helmut Wagner: Structural change, rebalancing, and the danger of a middle-income trap in China
No 7 Wing Thye Woo: A U.S. perspective on China's external economic disputes in the past 40 years and in the coming 40 years
No 8 Nigel Gould-Davies: Economic effects and political impacts: Assessing Western sanctions on Russia
No 9 Jouko Rautava: Kiina ja Venäjä – eripariset talouskumppanukset
No 10 Sergey Vlasov and Mariam Mamedli: Russia's pension system in the context of world experience and expected trends
No 11 Riikka Nuutilainen: Juanin kansainvälistyminen ei etene suoraviivaisesti
- 2019 No 1 Mariya Hake and Alice Radzyner: Western Balkans: Growing economic ties with Turkey, Russia and China