

WORKING PAPER

Understanding the Narrative behind OBOR Connectivity Projects - Traditional Donorship or Modern-Day Partnership? The Case of the Republic of Macedonia

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Abstract

In the increasingly complex landscape of donors, implementing agencies and financial institutions, new opportunities for capital investment projects are coming to play. At the same time, with the involvement of more stakeholders, the “rules of the game” tend to get more complicated. In the light of OBOR’s specific multilateralism, its multiple layers and the involvement of many different stakeholders, this article will focus on the implementation modalities pertaining to the connectivity agenda and infrastructure projects. **Is China emerging as a new donor in the traditional sense of the word or is the nature of the relationship a (new) type of modern-day partnership? Should the connectivity projects be considered China’s development assistance or win-win cooperation?**

Several parameters related to the project implementation and to the donor-recipient symmetry will be used to examine the relationship between China and Macedonia: benefits of such projects for the two countries (economic and other); role that different stakeholders from these countries have in the project implementation; type of financing modalities (grant/loan/other contracts); project viability and sustainability; strategic necessity for the beneficiary country; conditionality (if any) for the start and successful completion of the projects. Chinese presence in the country will be compared to that of the biggest traditional donor – the European Union. The findings will be used to draw some conclusions and recommendations that can help different parties involved in the projects to maximize their benefits.

Key Words: connectivity, infrastructure, donor, Macedonia

Introduction

China’s “peaceful rise” has been one of the geo-economic “wonders” which marked the end of the 20th and the beginning of the 21st century. Like any other ascending power, China seeks to make its imprint on the global scene and shape the current world order in a way that will contribute to its further development. The One Belt One Road Initiative (OBOR) is one of the main strategies to achieve that. It is first and foremost an initiative *“designed to uphold the global free trade regime and the open world economy in the spirit of open regional*

*cooperation*¹. However, it goes well beyond simple economic cooperation because, on one hand it strengthens the fundamentals which underpin economic development, such as transport, energy, IT, logistics etc, while on the other hand it aims to promote the “spillover” effects of economic exchange, such as peace, political trust, mutual understanding, cultural diversity, people-to-people ties etc.

In the landscape of overlapping regional alliances, unions and initiatives, OBOR is specific for the scope of its ambition and the lack of rigid institutional structure. The later appears to be a sine-qua-non to achieve the former and also one of OBOR’s key strengths, because it allows for greater flexibility and adaptability to different countries and situations. This makes the initiative acceptable and attractive across the vast geographic space that it covers, which is characterized by extreme diversity and big gaps in the level of economic and social development.

One of the main features that distinguish China’s OBOR is the “mutual benefit” for China and *all* other participating countries, no matter how different. China resuscitates the historic trade routes which enable quicker and easier access for its exports to Europe as China’s main trading partner and biggest export destination market. The revival of the historic trade routes includes construction and reconstruction of facilities connectivity as its lynchpin, but also aims to eliminate barriers to economic exchange and promote various types of cooperation. It also allows China to assert itself as a global player and to increase its influence beyond that of a regional super-power, on 3 continents, in over 60 countries - home to 60% of the world’s population, 75% of energy resources and 30% of the world’s GDP². Other participating countries place themselves on the pathway of the biggest economic exchange worldwide – that between the EU and China – hoping to boost their own economic growth and development by increasing their trade volume, creating investment opportunities, attracting Chinese tourists or using the funds made available through different channels to build their infrastructure.

The multi-trillion dollar initiative is largely sponsored by China, while other countries’ and private contributions to the projects top-up the investments that should provide *all* the stakeholders with some kind of return – financial or other. This paper aims to examine that particular aspect of “mutual benefit” in the relationship between China and the Republic of Macedonia, specifically in the context of the connectivity agenda and infrastructure projects. The questions that the article tries to answer are the following: With the deployment of Chinese funds to build connectivity infrastructure, is China emerging as a new donor in the traditional sense of the word or is the nature of the relationship behind the connectivity projects a (new) type of modern-day partnership? Should these projects be considered China’s development assistance or win-win cooperation?

¹ National Development and Reform Commission of the People’s Republic of China. (2015, March 28). *Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road*. p.2. Retrieved from http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html

² Shepard, W. (2016, November 22), *The Countries Building the New Silk Road - And What They're Winning in the Process*. Forbes. Retrieved from <https://www.forbes.com/sites/wadeshepard/2016/11/22/what-win-win-along-the-new-silk-road-really-means/#7d577acb7be7>

The institution tasked with the coordination of donor assistance in the Republic of Macedonia is the Secretariat for European Affairs. Established in 2004, the institution was given that name because in addition to managing the EU accession process, it managed the development assistance flowing into the country – at the time only from the EU and European countries like Germany, Sweden, Austria, Norway, France, the Netherlands and Switzerland. Nevertheless, in recent years, with the exception of the EU, most European bilateral donors withdrew from the country and their place has been taken over primarily by China, and to a lesser extent Japan. Yet, these countries have, at least until now, rarely been perceived as donors in the country.

The Republic of Macedonia was the first country in Central and Eastern Europe to use a portion of the €10 billion made available by China in the framework of the 16+1 cooperation to implement infrastructure projects. It took a concessional loan from the Chinese Export Import Bank in the amount of €574 million (over 20 years, with 2% interest rate and 5 years grace period) for the construction of a section of the European Corridor VIII Motorway between the cities of Kichevo and Ohrid (57km) and the construction of a section of the European Corridor X Motorway linking the capital, Skopje, to the city of Shtip (50km). Even long before the launch of the OBOR initiative or 16+1 forum, Macedonia has been a flagship destination for Chinese projects in Europe. It was the first country in Europe where a complete construction project (the primary school Rajko Zhinzifov in Drachevo, Skopje) was built entirely with Chinese development cooperation funds, following Chinese guidance, principles and standards. Moreover, the first major Chinese project in the energy sector in Europe was Kozjak hydropower plant, built by the China Water Electric company on the river Treska in 2004. In addition, Chinese development cooperation funds in the amount of €7 million were used to implement a project called e-Education, aiming to connect all the education institutions in the country. The Chinese company Huawei was chosen to be the implementing party following a public tender.

Given all of the above, several parameters which are related to the project implementation and to the donor-recipient symmetry will be used to examine the relationship between China and Macedonia: benefits of such projects for the two countries (economic and other); role that the administrations, companies and other stakeholders from these countries have in the project implementation; type of financing modalities (grant/loan/other contracts); project viability and sustainability; strategic necessity for the beneficiary country; conditionality (if any) for the start and successful completion of the projects.

The methodology will include desk research of available official documents and interviews with representatives from different stakeholders involved in the projects. Chinese presence in the country will be compared to that of the biggest traditional donor – the European Union. The findings will be used to draw some conclusions and recommendations that can help different parties involved in the projects to maximize their benefits.

Donorship VS. Partnership

Donorship and the Notion of Mutual Benefit

According to OECD's definition, "*aid is designed to promote the economic development and welfare of developing countries*" and includes grants, "soft" loans (where the grant element is at least 25% of the total) and the provision of technical assistance³. According to this definition, the biggest donor in the Republic of Macedonia and in the world in general is the EU, followed by the USA. China has been providing foreign assistance in different forms for over 50 years and is the world's biggest donor outside of the OECD's Development Assistance Committee⁴. Although it is quickly evolving, China's development cooperation (as China prefers to name its foreign assistance) cannot be completely framed under the DAC guidelines and needs to be considered under the light of China's long-established principles of foreign policy, the role that foreign assistance played in China's own development and its increasing economic and political weight⁵.

Some Western countries question the intentions behind China's assistance and claim that China is seeking to gain unequal benefits at the expense of the recipient countries. But, as one Chinese diplomat puts it, that is "*looking through colored spectacles*" (Chinese diplomat (2017 August 31). Skopje, Macedonia. Personal interview). One of the underlying principles of Chinese foreign policy and subsequently its development cooperation is "mutual benefit". If we examine the notion of "mutual benefit" in the policies of the biggest traditional (DAC) donors, it becomes clear that they are not providing development assistance unconditionally, for entirely "altruistic" reasons either. For example, the EU favors EU companies and products in all the tenders paid with European instruments. Notwithstanding some exceptions, namely to the benefit of the aid-destination countries, the "rules of origin" principle applies to EU's development cooperation in general as well. Its Member States apply the same principle in the framework of their bilateral assistance in order to promote their domestic companies and products. Another example would be USAID's provision of financing to projects that promote the American values as universal. In this sense, assistance needs to be considered as a foreign policy tool or strategy that benefits the donor as (much as) it benefits the recipient country. Hence, China is not an exception when it seeks some kind of benefit for itself in its development cooperation.

China and the EU- Different Concepts of Development Assistance

Chinese assistance today resembles a lot the assistance that the EU, USA and other DAC donors were providing to Macedonia a decade ago: a big amount of funds aimed to boost the country's economic growth, often used for connectivity purposes, such as infrastructure and

³ OECD (2017), Net ODA (indicator). doi: 10.1787/33346549-en

⁴ Zhang, J. (2016, July 19). *Chinese Foreign Assistance Explained*. Brookings. Retrieved from <https://www.brookings.edu/blog/order-from-chaos/2016/07/19/chinese-foreign-assistance-explained/>

⁵ De Haan, A., Warmedam, W. (2017, August 7). *New Donors and Old Practices: Does the Rise of China Challenge Aid Effectiveness?*. p.2. (Retrieved from https://link.springer.com/chapter/10.1057%2F9781137297761_10)

other visible projects⁶. Since then, a shift in the objectives of traditional development assistance is visible: the bigger part of the funds is used to support “soft” measures and political reforms that are a precondition for joining the EU and NATO, such as rule of law, democratization, strengthening civil society, freedom of media etc. Subsequently, the provision of funds is often conditioned by progress in these areas. Even in areas like transport, energy etc., the scarce funds that are maintained, like those allocated by the Western Balkans Investment Framework (WBIF) or the Instrument for Pre-Accession (IPA) are intended mostly for “soft” measures, such as road safety, border formalities, market opening etc. While not underestimating the importance of those measures, focusing only on them without making a significant improvement in the physical connectivity seems to be pointless.

Macedonia as a candidate country for EU membership receives far less funds from the EU in comparison to Member States that have access to the structural funds. Although the EU pledged to provide €1 billion in grants to the Western Balkans through the WBIF, the amount is too small to overcome the connectivity gap in the region and it comes with many “strings attached”.

One, the grant amount is largely insufficient because it is intended for 6 countries over the period of 7 years (2014-2020, the duration of one EU budget). Only €150-200 million are allocated annually, which is very little when it comes to infrastructure for the entire Western Balkans region.

Two, only a part of the project cost can be covered with a WBIF grant – between 10 and 50% in the areas of transport and energy. The grant co-financing goes from 10% for airports, 20%, for (re)construction of roads, renewable energy and gasification, up to a maximum of 50% for railway⁷. For the rest of the project amount, the applicant needs to secure a loan from one of the EU’s preferred financial institutions – CEB, EIB, EBRD or KfW. Until December 2016, a total of €600 million in grants were allocated for the 6 countries, along with €5 billion worth of loans⁸. Although the interest rates are smaller than those of the commercial banks, given the size of the countries – their debt levels and small GDPs, the loans still represent a big burden for the national budgets (Orhideja Kaljoshevska, member of the WBIF Steering Committee and expert on foreign assistance (18 August 2017). Personal interview). Speaking of Macedonia, the country has almost reached its debt limit and will probably be unable to use these funds in future.

Three, the allocation of the grants is conditioned by making progress in the implementation of the “soft” measures defined at the Western Balkans Summit in Berlin in 2014 and by the EU’s Connectivity Agenda (liberalization of the national railway and electricity markets, opening of joint border crossings, road safety, intelligent transport systems etc.). The country has thus far been reluctant to proceed with further market opening in terms of electricity fearing that it may lead to a surge in the electricity price and subsequent

⁶ Zhang, J. (2016, August 25). *How does Chinese foreign assistance compare to that of developed countries?*. Brookings. Retrieved from <https://www.brookings.edu/opinions/how-does-chinese-foreign-assistance-compare-to-that-of-developed-countries/>

⁷ Western Balkans Investment Framework. (2017, July 25). *Vademecum, consolidated version*.

⁸ Ibid.

social discontent, and in terms of railway, fearing that if the national railway company is privatized, it will need to be restructured and probably lay off a big number of its workers.

Four, only projects with a regional dimension - connecting 2 or more Western Balkan countries are eligible. In addition to that, the projects need to be ranked high not only in the countries' national agendas, but also in the EU's connectivity agenda for the region. For example, in transport, only projects along the TEN-T and SEETO comprehensive network, and in energy, only projects of interest for the Energy Community (PECI) are eligible.

Five, the decision making process alone often exceeds 1.5 years. Teamed with the time needed for allocation of technical assistance to conduct a feasibility study or draft a detailed design, the procurement process and the implementation, the completion of even the simplest project, in the ideal scenario, would take at least seven years⁹.

Chinese assistance presents somewhat different and a much simpler picture.

The initial amount pledged by President Xi at the launch of the OBOR initiative was US\$113 billion. However, judging by the scope and total value of the projects already underway, it is very likely that this amount will go up. In this context, there are specific financial instruments available, including US\$10 billion in preferential loans in the framework of the 16+1 cooperation, as well as China – CEE Investment Cooperation Fund with total starting capital of US\$435 million and a second phase envisaged to amount to US\$1 billion by the end of 2017¹⁰. In addition to these instruments and the loans provided by the Chinese national banks (Export Import Bank and China Development Bank), the other financing sources intended for the OBOR initiative in general are also available to Macedonia as well, such as the Silk Road Infrastructure Fund (US\$40 billion), the Asian Infrastructure Investment Bank (US\$100 billion) and the Shanghai-based New Development Bank (US\$100 billion¹¹). The projects come without any political conditionality for the country. They need to contribute to the larger agenda of the OBOR initiative, but that is hardly a precondition, since projects of predominant national interest for the beneficiary have been financed as well, as can be concluded from the abovementioned projects. Project selection is more flexible and is driven by a demand by the beneficiary, which ensures strong national ownership.

Who gains what?

Macedonia obtains funding for the much needed infrastructure, which it would probably not be able to find elsewhere – at least not under such favorable conditions. This enhances the prospects for its economic development and growth because better infrastructure facilitates transport, trade, investment and tourism. The infrastructure projects along the Corridors 8 and 10 have been stated to be of prime importance in all strategic documents since the country's independence from Yugoslavia in the '90s. They provide Macedonia with faster and cheaper connection to its neighboring countries which are among its top trading partners. In addition

⁹ Ibid.

¹⁰ China - CEE Fund. Retrieved from http://china-ceefund.com/Template/Condition_2.html

¹¹ Sneader, K. (2016, July). *China's One Belt One Road: Will it reshape global trade?* McKinsey podcast. Retrieved from <http://www.mckinsey.com/global-themes/china/chinas-one-belt-one-road-will-it-reshape-global-trade>

to that, given that it is a landlocked country, the projects provide the much needed quicker access to the seaports, especially in Greece, connecting Macedonia to destinations in Europe and Asia. Among the positive spillover effects, the direct cooperation between Macedonian and Chinese partners in the implementation of the projects contributes to increase the visibility of Macedonia in China, which should contribute to attract more Chinese visitors – tourists and potential investors.

Given that by its geostrategic location, Macedonia is on the pathway leading from China to Europe, financing connectivity projects in the country enables China to assemble one more of the necessary pieces for its One Belt One Road initiative. . Furthermore, China secures a new market for its companies, especially in the construction sector. The companies implementing Chinese assistance projects are Chinese, so is a big portion of the workforce and the materials used. Nevertheless, the ratio Chinese vs. domestic depends on the “deal” negotiated in different countries and different projects. In the case of the motorways in Macedonia, a minimum of 51% domestic workers should be hired, while in the case of the construction of the school, the main subcontractor as well as the supervision was Macedonian.

The “Chinese Way”?

Unlike other donors, China does not impose its rules or model and does not require the countries to implement any political or other reforms. It limits itself to the scope of the projects negotiated and implemented. This is in line with the fundamentals of Chinese foreign policy which is based on the principle of non-interference in the internal affairs of other countries, along with the principles of respect for each-other’s sovereignty and territorial integrity, mutual non-aggression, peaceful coexistence, equality and mutual benefit. In that context, the projects underway could be perceived as successful business deals rather than asymmetrical aid relations.

China has made an impressive success in constructing its own infrastructure networks which underpin its skyrocketing economic ascent. Thus, it seems to understand the Macedonian infrastructure needs and the fact that better connectivity is one of the preconditions for further economic growth. Moreover, given that China used to be until very recently aid-recipient itself, it has transposed that perspective into its foreign policy and used it to make its assistance more suited to the recipient countries’ needs.

China’s foreign aid is mostly oriented in the framework of the South-South cooperation, with its biggest portion going to Africa. Given its level of economic development, Macedonia is not a classic aid recipient according to OCDE’s definition and China’s support to the country cannot be treated as classic aid donorship. However, some aspects of the Sino-Macedonian relationship fall within the scope of China’s foreign assistance as defined by its White Paper on Foreign Aid issued in 2014. Namely, in addition to free training opportunities, donations of goods and materials as well as complete projects, China provides Macedonia with concessional loans for implementation of connectivity projects through the Chinese

state-owned Export-Import Bank¹². The loan conditions being far better than anywhere else, Macedonia simply resorts to these loans to implement the projects that it considers to be of utmost importance. Nevertheless, just like in the case of the WBIF, the constraint related to the level of public debt applies to the Chinese loans as well and imposes the need to find alternative financing models in order to maintain the initial intensity of the OBOR initiative and the Chinese engagement in the country. Moreover, thorough cost-benefit analyses and feasibility studies need to be implemented to justify and at the same time optimize the use of the funds.

Macedonia- Between China and the EU

Very often the EU does not seem to show understanding for Macedonia's infrastructure hunger. Although on its own it cannot help the country achieve the level of infrastructure it needs, it still views Chinese assistance as "unfair competition". Although it admits the need for a large-scale, long-term, Euro-Asian connectivity solution, such as the Belt and Road Initiative, it maintains the absolute necessity to do things by the EU rulebook. Yet, it is neither in the interest of China nor Macedonia to infringe EU rules, quite the opposite. The infrastructure projects that China undertakes, aim to showcase its ability to build according to the highest international and EU standards. This fits China's desire to improve its global image in terms of quality of its products, services and works and gain more access to the European market. Although many Chinese companies lack the experience needed to compete on the EU and international market, they are strongly encouraged by the Chinese Government to "Go Global" and quickly catching up (Member of the CEE Equity Partners Ltd, investment advisor for the China – CEE Equity Fund (21 August 2017) Personal interview).

On the other hand, Macedonia is a candidate for EU membership, which means that it will be at serious risk of facing criticism and pressure by the European Commission in case of breach of the EU rules. Moreover, if we consider the broader picture of the OBOR initiative in Europe, all major transport projects – both under implementation and planned, are parts of the Trans-European Networks defined by the EU. Their completion contributes to fill in the transport infrastructure gap between Western Europe and Asia. This would be naturally a logistical advantage for the EU and its exports to Asia, almost without any costs for the EU. According to an empirical study by Bruegel on EU's benefits from the OBOR initiative, "10% reduction in railway, air and maritime costs would increase trade by 2%, 5,5% and 1.1% respectively"¹³. In case of such a scenario, the gains for the EU would outweigh those

¹² Information Office of the State Council of the People's Republic of China. (2014, July 10). *China's Foreign Aid*. p.2. (Retrieved from http://english.gov.cn/archive/white_paper/2014/08/23/content_281474982986592.htm)

¹³ Garcia-Herrero, A., Xu, J. (2016, September 28). *This is how China's New Silk Road initiative could impact European trade*. World Economic Forum. Retrieved from <https://www.weforum.org/agenda/2016/09/this-is-how-chinas-new-silk-road-initiative-could-impact-european-trade>

for China¹⁴. It seems that European policy makers are yet to wake up to this potential and acknowledge the benefits that the EU could draw from OBOR¹⁵.

Conclusions and Recommendations

The OBOR initiative, with its unprecedented scope and development potential, is creating new possibilities for all the countries involved to draw benefits and enhance their prospects for economic growth. In that context, its focus on connectivity and the substantial source of financing for infrastructure projects allows Macedonia to improve its infrastructure and create more favorable conditions for trade, investment and tourism. It also allows China to assert itself as an important global player, gain better and quicker access for its exports to the European market and create new opportunities for its companies to do business and gain experience abroad.

China is a more attractive financing partner than the EU for Macedonia when the EU (WBIF) grant co-financing is low or when the projects do not meet EU's criteria and/or priorities. Chinese procedures are much more simple and straightforward for the beneficiary countries in comparison to the EU's "high-end bureaucracy". Nevertheless, for the sake of quicker and more comprehensive development of the country, the two financing sources should be considered and used in a complimentary, rather than competitive manner.

The EU maintains its role of the biggest donor in the country and political endpoint for the country to reach – once the EU acknowledges its readiness. This presupposes an asymmetrical relationship. China on the other hand puts emphasis on the "mutual benefit" as one of the basic principles upholding its cooperation with all third countries. Unlike the EU, China rejects any notion of conditionality that it could impose to the country in return for the funds. By doing so, it avoids placing Macedonia in a subordinate position and presents itself as a "business partner". The projects are negotiated and implemented as if they are mere business deals which are intended to satisfy all parties. How much benefit each "business partner" will gain depends only on their starting position and negotiating skills.

In future, it is important that Chinese investors and implementing agents hire a bigger percentage of local companies as suppliers and subcontractors. This will further boost the local economy in the beneficiary country and improve the image of Chinese investments in general. In addition, implementing agents need to pay greater attention to environmental and social standards, as well as EU's procedures which, although not binding in the case of Macedonia, since it is not an EU Member State, are still a concern and a constraint for the national government.

The level of public debt of the country has been rising with the numerous capital investment projects implemented in recent years. It is likely that soon Macedonia will be unable to provide sovereign guarantees. That is why it is necessary to exploit other financing

¹⁴ Ibid.

¹⁵ Shepard, W. (2016, December 28). *5 Upheavals To Expect Along The New Silk Road In 2017*. Forbes. Retrieved from <https://www.forbes.com/sites/wadeshepard/2016/12/28/5-upheavals-to-expect-from-the-new-silk-road-in-2017/#12e6ff9c6f0e>

and implementation models, such as concessions, Public-Private-Partnerships (PPP), Engineering-Procurement-Construction Contracts (EPC), EPC+F, etc. In addition, solid cost-benefit analyses and feasibility studies need to be conducted in order to demonstrate the sustainability of the projects, which is one of the measures for their long-term success.

Since the funds earmarked by China for the OBOR initiative are quite substantial, but not unlimited, it is essential for Macedonia to maintain its proactive attitude. Moreover, the country faces a dire need for infrastructure, shortfall of funds, as well as limited space for financial maneuvers. Therefore, it is important to conduct thorough analyses and strive to suggest more “smart” projects in order to have the funds deployed in a productive manner that will provide faster return and further stimulate its economic development.

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