



Weekly Briefing

Macedonia Economy briefing:
Macedonia's Transportation Infrastructure Gap
and Challenges Ahead
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Introduction

Historically, the Balkan Peninsula has been a crossroad, or rather a landbridge that connected the great civilizations of history. In the 2nd century BC, Romans built the Via Egnatia, a 1120km long East-West road that connected Durres at the Adriatic coast, Lake Ohrid, Thesalloniki to Constantinople (today's Istanbul), one of the several main arteries of the Roman Empire. Two thousand years later, the Balkans was still connected to the rest of Europe, as it was part of the Orient Express routes that connected London with Athens, Istanbul and Cairo by railway, one of the first and most significant long-distance railway routes in the world, not the least because the Orient Express trains had some of the most luxurious business travel facilities at the time. Today, Via Egnatia is a forgotten route, with many sections remaining isolated dirt and cobblestone roads in remote areas; while the Orient Express officially ceased to exist several years ago due to low demand caused by the bad conditions of the infrastructure.

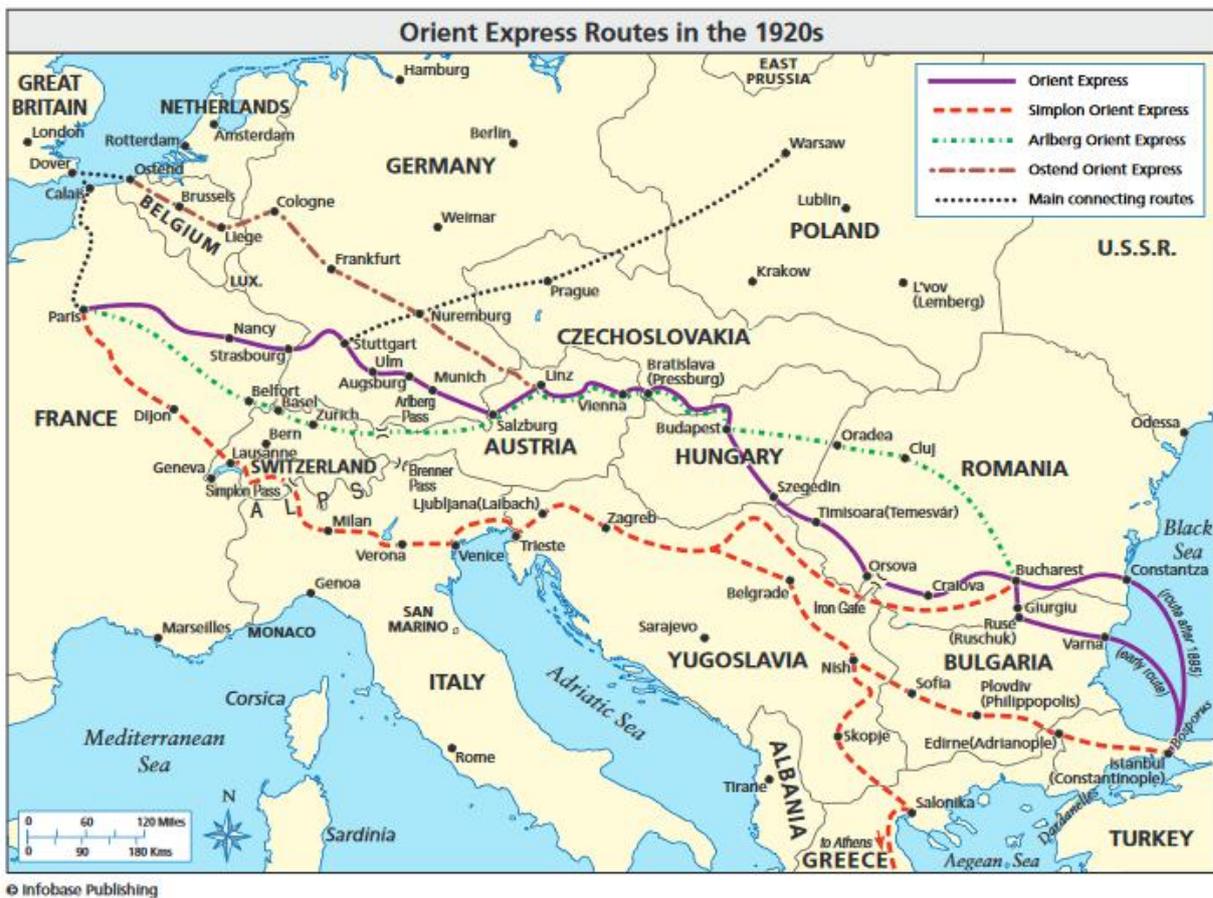


Image 1. Routes of the Orient Express in the early 20th century. The Simplon Orient Express on the way to Athens passed through Skopje. Today, there is no passenger train service between Skopje and Thessaloniki. Source: Infobase.

In the 21st century, the Republic of Macedonia, whose territory has been historically traversed by both Via Egnatia and the Orient Express, like the rest of the countries in the Western Balkans, suffers from a great infrastructure connectivity gap (or as the International Monetary Fund [IMF] puts it, there is “shortage of core public infrastructure” referring both to the density and quality of the existing transportation network). The infrastructure gap puts a strain on Macedonia’s overall capacity for economic development and its potential to achieve economic convergence with the European Union.

Since the independence of Macedonia in 1991, very little has been done to improve infrastructure connectivity. Often times, Macedonian citizens ironically say that “everything we have, was built in Yugoslavia” or that “the new guys cannot even destroy what communists had built.” The fact that the Gruevski government invested in an expensive project based on monuments and pseudo

historic buildings such as Skopje 2014 had amplified the dissatisfaction with the levels of investment in infrastructure.

However, things are slowly changing in Macedonia. This report will first show how gradually infrastructure became an important topic for the international partners and the Macedonian policy makers. However, as Macedonia has started to tackle its infrastructure gap, other issues emerged – as currently the three major infrastructure projects face serious challenges.

External Impulses

The primary impetus for the rising prominence of infrastructure on the policy agenda of Macedonia comes from abroad. Infrastructure slowly is becoming a more central theme in the agenda of foreign actors, which in turn makes it a prominent issue in Macedonia's foreign policy. This is a notable change, as historically Macedonia's foreign policy has predominantly revolved around governance issues, reforms and adjustments in order to join international political structures such as the EU or NATO, as well as solving historic and cultural with its neighbors. Moreover, economic diplomacy had been focused on attracting greenfield and brownfield investments in industrial production capacities.

However, there has been a paradigmatic shift in all three spheres. First, the EU has over time elevated the importance of improving infrastructure alongside governance reforms in the accession process; second, good neighborly relations now also revolve around infrastructure connectivity, and not just resolving historical and cultural issues; while in terms of attracting commercial investment, both investors but also the government have realized that there is little use of a production facility if it has inadequate physical connection to the domestic and foreign markets.

In terms of the international attention to the issue, Macedonia's infrastructure gap is now growingly discussed in light of the EU involvement of the region, and the enlargement prospects in the Western Balkans. Germany and

other member states of the EU have initiated the so called “Berlin Process” in 2014, which has later on been upgraded to “Berlin Plus” – an annual gathering of EU and Western Balkan leaders that streamlines the cooperation between the two sides; investment in infrastructure has played an important role in it. Under the Berlin Plus framework, after the Trieste Summit in 2017, for instance, Macedonia received a grant of 70 million EUR (of the total 194 million EUR for the whole region) that is to cover 46% of the costs of the railway to Bulgaria. International financial institutions are also growingly recognizing the issue of infrastructural gaps. The European Bank for Reconstruction and Development has been long trying to push the issue of public infrastructure to the mainstream of policymaking. The IMF has also recently made a significant statement on the topic, with recent report entitled “Public Infrastructure in the Western Balkans: Opportunities and Challenges” (published in 2017), which reflects on the shortages of infrastructure, and on the way to address the gap. Finally, the role of other, non-Western actors is also heavily focused on infrastructure. China comes first to mind, as through the 16+1 cooperation and the Belt and Road Initiative (BRI), it has provided the vision (“if you want to develop, build the roads first”) and the means to contribute to the development of Macedonia’s infrastructure – and is already involved in two large-scale projects. Turkey is also interested in taking part in infrastructural projects, the signature project being the Skopje airport. As of late, Japan has also demonstrated interest in developing environmental infrastructure in Macedonia, and may soon show interest in transportation infrastructure projects as well.

Infrastructure connectivity has also been central in the development of the new intra-Balkan relations. The connectivity dialogues initiated by the heads of governments and states of Bulgaria, Serbia and Greece have been big news for the region. Macedonia has started to growingly discuss connectivity with its neighbors – infrastructure development has been for instance high in the bilateral talks and the agreement with Bulgaria.

Domestic Developments and Challenges

Domestically, infrastructure development and connectivity have become important part of the political rhetoric of all political parties. In the parliamentary elections of 2016, as well as the local elections 2017, infrastructure was one of the central themes in the campaigns of the two major parties, SDSM and VMRO-DPMNE. In the new governmental program, there is a pledge to increase the public spending on infrastructure. The vision of the government is summarized in three concepts: “Macedonia megalopolis” which refers to providing infrastructure links between all the key cities none of which would take more than 90 minutes; creating “Macedonia free of accident spots” referring to the need to improve the rather low level of safety on Macedonian roads; and finally “Macedonia without mud,” which refers to the bad state of the transportation network in the countryside. The government also foresees undertaking a number of policy measures so as to facilitate infrastructure construction and modernization, and has provided a long list of priority projects. So far, however, we are yet to see the completion of major ongoing or the start of new major infrastructure projects (the start of the construction of the Skopje-Blace highway is expected to begin in 2018, but there are no official news yet). At the same time, government officials have been openly enthusiastic about the potential of infrastructure projects to contribute to the overall economic growth.

With the focus on infrastructure, SDSM follows a turn in the work of the government that has originated around 2013-2014. The data says that Macedonia’s policymakers have gradually become more aware and recently started investing more in infrastructure. In the period 2005-2013, Macedonia’s governments invested on average 1% of GDP into the construction of new and maintenance of existing infrastructure. This was a historical trend that has in fact supported negative claims. However, in the period 2014-2018, the investment in infrastructure has significantly increased, reaching 2-3% of GDP. According to the IMF, in turn, infrastructure investment has also contributed to increasing of the GDP growth in this period. The VMRO-DPMNE’s government has started

four massive projects, depicted in the table below. It has also relied heavily on these projects to portray itself as a successful party. In fact, once the first three out of the four major infrastructure projects (all of them motorways) are finished, Macedonia's network of expressways and highways will note about 50% increase in length.

Project	Miladinovci - Shtip	Kichevo-Ohrid	Smokvica – Demir Kapija	Kriva Palanka – Beljakovce
Type	Motorway section	Motorway section	Motorway section	Railway section
Length	46 km	57 km	28 km	34 km
Initial cost	€226.7m	€411.3m	€245.0m	€140.0m
Foreign creditor	EXIM Bank of China	EXIM Bank of China	EBRD/EIB	EBRD
Project start	2014	2014	2012	2014
Initial completion target	2017	2018	2017	2018
Complications	Corruption Land property issues	Corruption Land property issues Revisions of some of the sketches	Corruption	Delay in payment of the EU funding
Additional costs	N/A	€120m (est)	N/A	N/A
Amended completion target	2018	2021	2019	2022

Table 1: The Four Major Transportation Infrastructure Projects in Macedonia. Source: IMF and own research.

However, while political will makes one part of the process of infrastructure development, competence and diligence are equally important. Regardless of the positive vision and the initiation of the construction of the three motorway sections, for instance, they all have been plagued by corruption and other issues, delayed, and turned out more costly than originally planned. In all three cases, former VMRO-DPMNE officials face various corruption charges – from violating laws on competitiveness to taking a bribe. The corruption charges are now investigated by the Special Public Prosecution. In addition to this, in the cases of Kichevo-Ohrid and Miladinovci-Shtip motorways, there were legal issues regarding land ownership, expropriation and compensation of land owners. Finally, in the Kichevo-Ohrid case, moreover,

there has been an instance of mismatch between the projections of the work and the actual physical landscape where the work is carried out, which also called for prolongation of the project. Issues regarding the relations and payments between the main contractor (Sinohydro) and the subcontractors have also emerged.

At the same time, while such issues do not plague the railway connection to Bulgaria, there has been a substantial delay in the payment of the EU funding awarded at the Summit in Trieste (as the German Chancellor noted during a meeting with Prime Minister ZaeV, while for EU in this case money is not an issue, the slow procedures are).

Conclusion

Macedonia's significant infrastructure gap has not been properly addressed for most of its independence. However, thanks to the external impetus and the gradual change in thinking of Macedonian policymakers, infrastructure is now part of the mainstream discussions on the economy. Yet, despite the political will and the kickoff of several important projects, issues related to their implementation have emerged. The problems regarding the infrastructure projects are now heavily politicized and part of a blame-game between the government and the opposition. The government of SDSM blames the failures on VMRO-DPMNE; while VMRO-DPMNE argues that while they were in power, things went smoothly, but with the government change, suddenly all projects experienced difficulties. They also blame the legal cases against them on political reasons.

Regardless of the outcome of who is responsible for the complications, the case of Macedonia shows that it is difficult to note economic achievements without having the resources, capabilities and most importantly, the diligence required for such undertakings. One important lesson for future projects in Macedonia's infrastructure sector is that there has to be more meticulous and thorough preparation stage. While once successfully completed, the

infrastructure projects will demonstrate their usefulness and added value, in the process of their construction they have caused way too much political controversy, and if the reports on mismanaging the funding are true, they have indeed cost Macedonian citizens way too much.