



Weekly Briefing

Macedonia Economy briefing:
The Controversial Case of the Kichevo-Ohrid Highway
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Introduction

The 57 km long Kichevo-Ohrid highway is perhaps the most significant transportation infrastructure project that Macedonia's government has undertaken in recent years. It will greatly improve the connectivity between Ohrid, the center of Macedonia's tourism industry, and the rest of the country. The highway, whose construction started in 2013, is funded by a 411 million EUR loan of the Chinese ExIm Bank (the cost is expected to significantly increase), while the principal contractor is the Chinese SOE Sinohydro. The same arrangement goes for another highway, from Miladinovci (near Skopje) to Shtip, which is 47 km long, and costs 226 million EUR. The construction of the highways is regulated by a Special Law. Once hailed as a bright example of China-led cooperation efforts, however, the Kichevo-Ohrid highway since 2015 became a subject of major controversies. First, in 2015, as part of a broader anti-government campaign, the then opposition leader, Zoran Zaev publicly broadcasted leaked wiretaps that showed evidence of grand corruption in the arrangement of the deal. After the change of Macedonia's government in 2017, a number of technical issues emerged which led to significant delays in the construction of the highway, while the Special Prosecutor's Office (SPO) has proceeded with an investigation against former government officials on the account of abuse of power in arranging the deal. While the story of the highway is not known to the public in full yet, here we try to reconstruct some of it by relying on two proxies: the insights from the court hearings of the officials from the former Macedonian government, and the public statements made by the current one.

Insights from the Court Hearings

One of the several cases that the SPO has raised against officials from the former government of VMRO-DPMNE and DUI looks at the circumstances in which a decision was made, to take the ExIm loan and hire the company that implements the construction of the Kichevo-Ohrid and Miladinovci-Shtip highways. The case is symbolically titled “Trajectory.” The claim of the SPO is that former Prime Minister Nikola Gruevski, along with the former Minister of Transport Mile Janakieski, the former Vice Prime Minister in Charge of Economic Affairs, Vladimir Peshevski, and the former head of the Public Enterprise for National Roads Ljupcho Georgievski, have illegally awarded Sinohydro the implementation of the projects in question. This decision is claimed to have resulted with a loss of 155 million EUR of Macedonia's public funds. The key evidence in the court case are the leaked wiretaps from the phone calls between the officials, as well as transcripts from their correspondence via phone messages.

One of the major claims in the case is that the former government officials did not consider an offer that was provided by a competitor of Sinohydro, that is another Chinese SOE, China Water Electric (CWE). The two companies are known to be fierce competitors around the world. In one of the tapes, the former Minister of Transport and Connectivity complains to an associate that CWE made its offer in the last minute, just as the government finished bargaining with Sinohydro. However, in the next period, the government decided not to consider the offer by CWE at all, and proceeded with signing the agreement with Sinohydro. Former Prime Minister Gruevski was instrumental in the process, as he used his authority to ensure that his subordinates would proceed with the Sinohydro deal.

This leads to the second claim by the SPO, that the government had circumvented the Law on Public Procurements. At the time, the only document that regulated the construction of the highways was an agreement between the governments of Macedonia and China. However, this agreement did not specify which company should get the contract; moreover the Chinese government

representative never had a requirement of that sort. For them it was all the same. The situation in which the government of Macedonia found itself after receiving the offer by CWE, according to the SPO, implies that it should have opened a tender through which Sinohydro and CWE would have competed for the contract. The government, however, did not do this. While the implementation of the project was later on regulated with the Special Law, this Law is said not have been enacted only after the agreement with Sinohydro was made.

More evidence was brought in front of the court in Fall 2018. There is no verdict on the case of grand corruption and breach of procedures in the case of the construction of the Kichevo-Ohrid highway yet. However, in the eyes of the public, the officials from the former government are already considered guilty. The case has damaged not only their reputation, but also the perception of Macedonia-China relations. Officials from the former government claim the case, as well as other cases raised by SPO, are politically motivated.

Chronology of the Official Statements by the Government

One of the first major decisions of the SDSM-DUI government after taking power in 2017, was to halt the construction of the two highways that are funded via Chinese loans and co-implemented by a Chinese SOEe, those are Kichevo-Ohrid and Miladinovci-Shtip. Initially, it was not known why the construction works were stopped. What was clear is that both projects were not going to be completed on time. Premier Zaev ensured the Chinese Ambassador Yin Lixian that the projects are not stopped because of political reasons, but because of technical issues. One of the reasons for the delay in the work on the Kichevo-Ohrid highway was speculated to be poor planning of the alignment of the road. Moreover, it turned out that the cost of the highways increased with the change in the currency rates (as in the case of Montenegro).

In September 2017, during a meeting with the Chinese Ambassador to Macedonia, Madam Yin, Vice Premier Kocho Angjushev adopted a conciliatory tone. He argued that the two highway projects funded by the Chinese ExIm

Bank are of particular importance for improving Macedonia's competitiveness, as well as the national and regional economic growth, and restated the commitment of the Macedonian government to make sure the highways are completed as soon as possible. At this point, he referred to having found a successful solution and “compromise” between the government and Sinohydro.

In November 2017, Angjushev, during a Q&A session in the Parliament, argued that the fault for the delays in the work on the two highways were to be sought with the previous government, and that the current government was working on controlling the damage.

In January 2018, before the expiration of the initial deadline for completion of the Kichevo-Ohrid highway, the Macedonian government and Sinohydro had not yet reached an agreement on how to continue the cooperation, and it was uncertain whether the construction works will continue, and whether Sinohydro will remain the principal contractor. The Minister of Transport and Connectivity, Gjorgji Sugareski however reassured the public that the government has the situation under control and that the negotiations with Sinohydro are going smoothly.

In March 2018, the government and Sinohydro signed the first Appendix to their contract, which prompted the first amendment of the Special Law. Angjushev discussed the importance of infrastructure construction projects for the economic development of the country. However he argued that the Kichevo-Ohrid highway was a serious challenge, and complained that the Chinese partners had set bad conditions and asked for more money. This according to him led to a choice between “two evils” - the government could void the agreement with Sinohydro, which would mean that it would have to pay penalty fees to the Chinese SOE; on the other hand, it could continue with the construction work – but this would significantly increase the costs. The two sides negotiated on prolonging the deadline for the completion of the highway. By the end of the month, the two sides agreed that the new deadline for completion would be June 30, 2021. This was later stipulated in the First

Amendment of the Special Law on the construction of the two highways. The government opted to continue the works, because, as Sugareski argued, already more than 50% of the work had been completed. The complication and the delays were said to be a result of inadequate planning and mismatch between the projections and the reality on the ground.

In June 2018, Macedonia faced the sobering reality that its economic growth will not meet the projections. One reason for the economic slowdown, according to Angjushev was the slowing down of the construction works on major infrastructure projects, including the ones built by Sinohydro, and in particular the Kichevo-Ohrid highway. Angjushev however argued that construction needed to be stopped to ensure financial prudence. He argued that only after all details are set with the Chinese partners, the construction can continue.

In September 2018 it was announced that the alignment of the road will not be altered after all. The two sides bargained to cut the costs, and Sinohydro obliged not to use the right to ask for penalties because of the stoppage of the construction works. The goal of this agreement, which was then regulated by the Second Amendment of the Special Law aimed at ensuring that the construction will finally proceed. However, the two parties are yet to finalize the terms for completion of the highway. What is certain is that the completion of the highway will require more funds. As Angjushev repeated, the government “inherited” a number of technical problems from their predecessors. Angjushev also pointed out there has been significant deviations between the market prices for purchasing of materials and services, and the prices paid by the contractor and the local subcontractors. He argued that upon thorough analysis, the government managed to rework the conditions for the project and even managed to significantly reduce the costs.

In the meantime, some engineers and architects argued that some of the major difficulties stemmed simply from the challenging mountainous terrain through which the highway is being built, and that *trpacta* was not the main

issue. One of the arguments was that a 4 km long tunnel was originally planned to be built through a rock; however, after the start of the work, it turned out that a significant part of the soil through which the tunnel is supposed to be built is much softer.

With the Second Amendment of the Special Law signed in September 2018, additional 205 million EUR from the original credit from the ExIm bank were made available, that were to serve to restart and intensify the construction works. The government made the compromise in order not to further complicate the economic difficulties, and not to endanger the liquidity of the companies involved in the construction (in particular the local subcontractors), that greatly depended on this particular project. Negotiations between the two sides continued in September 2018, regarding the additional costs/measures to be taken.

In early October 2018, new problems regarding the construction of the highway emerged. The original projection was that the road should pass over the water reservoir of the city of Kichevo. This required changing of the projection which also meant further adjustments on the ground. However, the Director of the Public Enterprise for State Roads, Zoran Kitanov, restated his belief that the new deadline for completion (summer 2021) will be met, and even expressed his hope that once completed, the highway will be extended to the city of Struga and to the border with Albania. According to Kitanov, all the delays and changes in the project were needed to ensure that the highway will be usable once completed. He announced that different sections of the highway will be put to use as they are completed.

Currently, Macedonia is expecting the signing of the third Appendix of the agreement with Sinohydro, and consequently, the third Amendment of the Special Law. Angjushev argued that with the new arrangements Macedonia will save 70 to 100 million EUR, primarily due to the reduction in the difference of the costs offered by the contractor, and their market prices. However, there

have been no official information as to what would be the total cost of the highway as of yet.