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China's New "Debt Trap" in Montenegro?

-- A Study based on the Highway Project

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Abstract

The Belt and Road Initiative, started in 2013, is seen as China's way to expand its influence globally. It involves infrastructure projects in different countries, including Montenegro, where China has invested in a north-south highway project. This project has raised concerns about the "debt trap," where developing countries become vulnerable to China's influence due to unsustainable loans for infrastructure projects. However, an analysis of Montenegro's debt and creditor structure shows that the country's debt situation hasn't significantly worsened due to the project. Montenegro's public debt is still at reasonable levels, and China's share of the debt is relatively small. Also, the historical and political context of the highway project in Montenegro suggests that China's involvement was based on commercial considerations rather than a deliberate attempt to create a "debt trap." Additionally, the nature of the project, which is still owned by the Montenegrin government, makes it unlikely for China to gain significant economic or military benefits from the investment.

Keywords

Belt and Road Initiative; Debt Trap; Infrastructure Projects; Montenegro; China; Public Debt; Commercial Considerations.

1. Introduction and the So-called "Debt Trap"

The Belt and Road Initiative was launched in 2013 and is widely considered a geopolitical strategy to create a new, China-centered order in Eurasia, and even around the world [5]. Montenegro is located in the west-central part of the European Balkans, bordered by Albania to the southeast, Serbia to the northeast, and Bosnia-Herzegovina and Croatia to the northwest. Montenegro has a long history of cooperation with China and is a key country in the "Belt and Road" cooperation.

In 2014, China and Montenegro announced cooperation on a north-south highway project, with the Montenegrin government providing a sovereign guarantee for the project loan. The highway project starts in the southern city of Bar and connects to Serbia in the north. The project is being constructed with a loan of $9. 44 billion from the Export-Import Bank of China to the government of Montenegro. The loan agreement was officially signed by the China Exim Bank and the Ministry of Finance of Montenegro in September 2014. The interest rate on the loan is a fixed rate of 2%. The loan has a term of 20 years with a grace period of five years.

The so-called "debt trap" refers to China's provision of unsustainable loans to developing countries for infrastructure projects so that when these countries run into financial difficulties, Beijing can seize these assets for strategic or military purposes [5]. This narrative originated in 2017 in a New Delhi think tank on the Sri Lankan port of Hambantota and was widely disseminated among the world's media and policy elites [2]. Brahma [1] argues that China

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supports infrastructure projects in strategically important locations in countries through the Belt and Road Initiative, often by providing huge loans. This puts countries in a debt trap and makes them vulnerable to China's influence. Today, this "debt trap" argument is being applied again to the Montenegro highway project.

In a report entitled Examining the debt implications of the Belt and Road Initiative from a policy perspective, the US Center for Global Development first raised the issue of Montenegro's "debt trap". The report argues that Montenegro is one of the 10 to 15 countries whose public debt levels have increased as a direct result of the Belt and Road Initiative [4]. Since then, Montenegro's "debt trap" has been the focus of Chinese infrastructure projects in Europe. The Center for Global Development (2019) cites the World Bank as arguing that the root cause of Montenegro's rising public debt is the freeway project linking the Montenegrin port of Bar and Serbia. The report also cites the International Monetary Fund's view that the second and third phases of the project can only continue to be realized through concessional loans, which would otherwise result in a debt default.

In my view, the available evidence challenges this position: the highway project did not worsen Montenegro's debt and China owns only a small portion of Montenegro's foreign debt; China's status as a latecomer could not shape the substance of the project and control it; economic factors were a direct factor in China's entry into the project; the interests of Montenegro's political elite were important in shaping the project, and China could not take ownership and achieve its economic and military goals.

2. Debt and Creditor Structure

The highway project did not have an allegedly serious impact on Montenegro's debt and structure, leaving the country's debt situation seriously deteriorated and under China's control.

In terms of debt data, Montenegro's public debt to GDP ratio has never exceeded the EU-27 and Euro-16 averages since the project landed. Even with the current epidemic hitting the European economy, Montenegro's debt situation has remained low and stable, with no significant spikes. According to Eurostat, as of the fourth quarter of 2021, the debt-to-GDP ratio within the EU has reached 87.9%, and within the eurozone, it reached 95.4%. In contrast, Montenegro's public debt in the same period was only 73.8% of GDP and decreased significantly from the previous year, indicating a positive trend. In terms of historical data and averages, the average debt level of the EU-27 from 2014 to 2021 is 83.9%, and the average debt level of the 19 countries in the Eurozone is 90.4%. And since the project landed in 2014, the average level of debt to GDP in Montenegro is 69.5%, which is in a reasonable operating range. In terms of debt levels, not only has the Chinese project not made Montenegro's debt significantly and consistently worse, but Montenegro's debt is showing signs of getting better. This means that Montenegro's economic situation is not caught in the so-called trap and accusations of a deteriorating debt situation in Montenegro are unfounded.

Table 1. EU, Eurozone and Montenegro public debt to GDP (%)

Region	2014	2015	2016	2017	2018	2019	2020	2021	Average
European Union 27	86.6	84.8	84.0	81.5	79.5	77.6	89.9	87.9	83.9
Eurozone 19	92.8	90.9	90.1	87.7	85.8	84.0	97.0	95.4	90.4
Montenegro	58.5	64.6	64.4	65.7	70.1	76.5	82.6	73.8	69.5

Source: Ministry of Finance and Social Welfare of Montenegro, https://www.gov.me/en/article/report-on-the-central-government-debt-as-of-31-march-2022; European Union Eurostat, https://ec.europa.eu/eurostat/databrowser/view/gov_10q_ggdebt/default/table?lang=en

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In terms of the creditor structure of Montenegro's state debt, as of the first quarter of 2022, Montenegro's public debt is dominated by external debt, with 23 external entity creditors, including policy banks, EU member governments, financial institutions and private creditors. China is the only creditor in the Asia-Pacific region. The loan from China Exim Bank is the second largest external debt after Eurobonds, accounting for 18.63% of Montenegro's external debt and 16.83% of public debt, but this share is less than half of the first creditor. And judging from historical data, this share is shrinking due to the completion of projects, meaning that the level of China's debt in Montenegro is decreasing. This suggests that China is far from being the largest shareholder for Montenegro in terms of manipulating state practice, and its share of debt is only a small percentage.

Table 2. Share of major foreign creditors' debt in Montenegro's external debt (%)

Foreign creditors	First Quarter 2022
EUROBOND	47.70
CHINA EXIM BANK	21.49
SYNDICATED LOAN - PBG	6.81
SYNDICATED LOAN - PBG2	6.81
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT	5.09
EUROPEAN INVESTMENT BANK	2.76

Source: Ministry of Finance and Social Welfare of Montenegro, https://www.gov.me/en/article/report-on-the-central-government-debt-as-of-31-march-2022

In terms of historical data, the structure of Montenegro's creditors and the size of its external debt deteriorated from the international financial crisis. Eurobonds quickly became the largest creditor of Montenegro's public debt after the financial crisis, peaking at close to 50% in 2015. In terms of size, external debt in Montenegro's public debt was only €900 million in 2010 and reached €3.1 billion in 2019. So Montenegro's public debt has been retired high by Western creditors in the wake of the international financial crisis. It is unfair to accuse China of promoting the deterioration of Montenegro's debt situation and even borrowing creditor status to control Montenegro's development.

3. A Logically Untenable "Trap"

The accusations of the highway project deliberately highlight the particularities of China, while ignoring the historical and political aspects of the project and the process of Chinese involvement. Starting from the elements of the "debt trap" discourse, it is also difficult to find evidence that this is a well-designed project that will bring real benefits to China.

First of all, the former President of Montenegro Vujanović has pointed out that Montenegro's vision for this freeway existed decades ago. The highway would connect Montenegro's largest coastal towns and ports with Belgrade, the most economically powerful city in the western Balkans. It would enable full cooperation between Montenegro and Serbia. For the financing and construction of the highway, the Montenegrin government accepted an initiative from the neighbouring Croatian road construction company, which offered to ensure the implementation of the project. Unfortunately, however, this company was unable to meet the criteria and obtain sufficient funding [7].

This means that from the beginning the highway was Montenegro's own choice, the tender was completed before receiving Chinese support, and it was a development project that initially belonged to Montenegro, Serbia and Croatia. In other words, the project was not initiated or

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imposed on Montenegro by China, which was a "latecomer" to the project. There is no factual basis for designing a "trap".

Secondly, Chinese participation in the project was the least costly business move for Montenegro. The then President Vujanović stated to the public that the loan terms offered by China Exim Bank were the most favourable for the project and that no other bank or financial institution could compare. Therefore, after comparing all government offers, the Montenegrin government chose the loan from China Exim Bank. This means that China's participation in the project is based on commercial behaviour. The debt service pressure created by the terms is relatively low, and there is no "trap" created to increase Montenegro's debt.

Judging from the critical voices during the development of the project, the project may have been mixed with political interests. Misconduct by the elite in the recipient country, Montenegro, has led to many of the project's problems. While most of the work was done by Chinese road and bridge corporations, up to 30 per cent of the benefits by value went to companies with ties to Montenegrin government officials. For example, Bemax, which is known for its substantial involvement in government-related business deals, received a €240 million interest in the highway project. Notably, one of the owners of the company is Blazoc Đukanović, the son of the president [6]. At the same time, Grgic Mladen [3], director of the Montenegrin Investment Agency, believes that the project actually lacks feasibility. This means that China is actually involved in a flawed project that is dominated by Montenegro and bears the blame for the negative aspects of the project.

Finally, starting from the elements of the "debt trap", it is difficult to assume that China can benefit from the "trap". The concept of a "debt trap" originated with the construction of the Hambantota port in Sri Lanka [2]. The accusations of China benefiting from the port revolve around issues such as ownership of the Hambantota port, trade economics, and military ports. However, for the Montenegro project, EU researchers such as Zweers [8] note that "it is unlikely that the Exim Bank loan will lead to a Chinese entity taking ownership of the highway at some point. Under a law passed by the Montenegrin parliament in 2014, third parties cannot acquire ownership or any other property rights to it. Therefore, although the terms of the bilateral loan agreement with Exim Bank have not been disclosed, confiscation of the highway or part of it in the event of a debt default is not possible." Secondly, the Montenegro highway project is an infrastructure project involving remote mountainous and urban areas, which are very far from China. Compared to Sri Lanka's port project, the highway cannot realize any military or economic benefits. Therefore, it is difficult to apply the "debt trap" discourse to the Montenegro project.

4. Conclusion

Media or think tanks with negative views on China's highway project in Montenegro see it as a debt trap mainly based on two points. First, the public debt of the country targeted by the infrastructure project is too high as a share of GDP and is further worsened by the project. Second, China has shaped and profited from the project trap through its own diplomatic control.

Both arguments are difficult to sustain through data and investigation of the project. Montenegro's debt situation has not exceeded the average debt level of EU countries and Eurozone countries for almost a decade. The project has been developed for a long time, China is involved as a latecomer to the economic activity, and the ownership of the project remains with the Montenegrin state government. An analysis of the project's development prospects makes it difficult to assume that China will realize any economic, military or trade benefits from it, and does not meet the definition of the elements of a "debt trap". The internal political struggles and complex interests of the Montenegrin state, from preparation to construction, maybe the reason for the project's many problems. For China, it is more important to consider

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how to conduct sound due diligence before acting and to have a proper understanding of the substance of the project to avoid the shadow of a "debt trap" to continue to loom over the next project.

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