

Ukraine, Belarus and Moldova and the Chinese economic expansion in Eastern Europe

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The countries of Eastern Europe and China have been increasingly interested in deepening bilateral contacts over the past few years. In the case of Ukraine, Belarus and Moldova this has been caused by the bad economic situation which was in part caused by the consequences of the global economic crisis of 2008 and the desire to establish closer political relations with a country whose significance on the international arena is continually growing. Each of these countries has different expectations regarding the scale and the nature of co-operation with China. Chisinau wishes only to boost trade, whereas in Minsk and Kyiv, Beijing is also presented as a strategic partner whose investments may not only help the indebted economies recover but also strengthen the position of these countries in their dealings with the EU, and especially with Russia. Beijing sees co-operation with these countries in differently, and its offer is much more modest than Belarus and Ukraine are expecting. Eastern Europe is one of the last parts of the world with which China is activating its co-operation. This is not a priority region for Beijing. China wants to derive economic benefits and to diversify the markets on which it invests its financial surplus, and it does not intend to extend its political dialogue with Ukraine, Belarus and Moldova beyond the framework which determines its economic interests. The main reason for this is the nature of relations between Russia and China. Beijing sees its partnership with Moscow as more beneficial, and will not offer these countries support in their relations with Russia since in its opinion they belong to Russia's sphere of influence.

Minsk and Kyiv are pinning too much hope on their co-operation with Beijing, while China offers no real counterbalance to the Russian and EU influences in these countries. Nevertheless, it should be expected that China will capitalise on the beneficial political climate in Ukraine, Belarus and Moldova to reinforce its influence in a region whose location will facilitate its expansion to the EU and the Customs Union markets. In the medium term, Beijing may become a major economic player in Eastern Europe. In a decade's time this may translate into political influence. Meanwhile, in the short term, China's financial engagement in Ukraine, Belarus and Moldova will contribute to increasing the debts and deepening the foreign trade deficits of these countries.

China's strategy for Eastern Europe

China's role on the global market has grown in a very short time as a consequence of the global economic crisis. It became the world's second largest economy, with budget reserves estimated at around US\$3 trillion. It is thus a desirable investor and political partner. At the same time, this crisis has made it necessary for China to diversify its investment portfolio and to reduce its share of US treasury bonds. Facing these challenges, China intensified its activity on global markets, which also encompassed Eastern European countries. Contacts with them, with the exception of Belarus, have not been developing at a rapid rate to date.

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Furthermore, Beijing does not view Eastern Europe as being essential, mainly due to the lack of attractive assets and the small deposits of energy and mineral raw materials there. Another reason is the special partnership existing between Beijing and Moscow. International co-operation is important for both of them. Besides, Russia

is a major supplier of raw materials (mainly oil) to China and an important economic partner. In 2011, Beijing's trade with Moscow was worth approximately US\$80 billion, and its total trade with Ukraine, Belarus and Moldova was only around US\$12 billion¹.

All these factors have an impact on the structure of how Chinese capital is invested in Eastern Europe and which financial instruments are used. These are **predominantly loans granted for infrastructural projects and the creation of joint ventures, with low level of direct investments and the acquisition of local firms**. From China's point of view, countries in this region also have advantages. These include some post-Soviet technologies used mainly for military purposes and to a lesser extent in industry and agriculture; the beneficial geographical situation which facilitates the sale of Chinese goods to the EU and Russia; the relatively cheap workforce; and the favourable attitude of the political elite.

Belarus: China as a source of loans and legitimacy for the regime

Beijing's presence in Eastern European countries is most easily observed in Belarus. The symbolic beginning of the activation of Belarus's policy towards China was marked by President Alyaksandr Lukashenka's visit to Beijing in December 2005, although Chinese-Belarusian political co-operation had been developing rapidly also before that date². Since then, senior officials have visited China often, and Chinese leaders and low ranking politicians have visited Belarus – albeit less frequently (for example, the visits by Prime Minister Wen Jiabao in 2007, Vice President Xi Jinping in 2010 and the Parliamentary Speaker U Bango in 2011).

Alyaksandr Lukashenka has intensified co-operation with China since the presidential election in December 2010. Pay rises in the public sector before the elections have brought about inflation and a deep crisis in the financial sector. In turn the violent crackdown on the demonstrations after the election has caused relations between Belarus and the EU to be frozen, and an entrenchment of Minsk's political and economic dependence on Russia. Given this situation, China is seen in Belarus as a source of cheap loans and investments necessary to support the inefficient and indebted economy. Partnership with Beijing is also aimed at creating the impression that Minsk has some room for manoeuvre in foreign politics. Although Lukashenka is aware of the fact that relations with China will not outbalance Moscow's influence³, this does not prevent him from presenting China as a strategic partner and making efforts for Belarus to be given the status of an important centre for the production and distribution of Chinese goods to the EU and the Customs Union markets.

¹ On the basis of data from the statistical offices of Moldova, Ukraine, Belarus and China, and own calculations.

² China was the first country from outside the CIS area which Lukashenka visited after being elected president in 1994. For more see: Steven J. Main *The Bison, the Dragon, the Peacock and the Lion: Aspects of Contemporary Belarusian Foreign Policy*, Defence Academy of the United Kingdom, December 2006.

³ See for example the interview given by Lukashenka for Russian television (December 2011) <http://www.youtube.com/watch?v=7vXjy8FWqyQ>

As a result of meetings between the leaders of the two countries over the past two decades, Beijing has made **credit lines available to Belarus worth a total of US\$16 billion**⁴, and several contracts for the implementation of joint projects have been signed. One effect of this has been the constant growth in trade⁵ (see Appendix, Table 1). In 2011, China was the ninth largest recipient of Belarusian exports and the third largest exporter to Belarus. Belarus predominantly exports potash fertilisers to China (44% of total exports), and China exports mainly processed goods to Belarus. Joint projects worth totalling US\$5.5 billion had been implemented or were underway in February 2012, and the US\$10.5 billion still available as part of the credit line opened are to be utilised over the next few years. The largest of the projects carried through so far included: the creation of the BeST mobile telephone network; and increasing the capacity at the Minsk heat and power plant and the construction of a new block there. Furthermore, the modernisation of three cement factories and the construction of a housing estate and a hotel in Minsk are underway. China and Belarus are also planning a number of new projects, the estimated total value of which will be between US\$7 and 8 billion, the largest of which is the construction of the industrial park in Smalyavichy near Minsk (see Appendix, Table 3).

Beijing is also interested in obtaining technologies from Belarus. For this purpose, joint ventures have been established in China, predominantly in Harbin, with the participation of such Belarusian companies as BelAz, MTZ and GomSelMash. They are involved in the production and distribution on the Chinese market of such goods as agricultural machinery and large-size construction vehicles. In turn, the Belarusian government has been making efforts to make Belarusian products more easily accessible on the Chinese market. For this purpose several trade agencies of the largest Belarusian companies, such as Belkali, BelAZ and Belneftekhim, have been opened in China.

The political component in relations between Minsk and Beijing has been emphasised very strongly by the Belarusian government, whereas **China treats the political dialogue merely as an instrument which helps it achieve its economic goals. The priority task is to invest part of its financial surplus in the form of low-interest loans secured with government guarantees. The model of China's engagement seen in Belarus is typical of the entire Eastern European region, and its main goal is to support Chinese exports.** The companies from China active in this region are suppliers of equipment and technologies and the main contractors in

infrastructural projects which are financed with Chinese loans. In turn, the scale of direct investments is small; one proof of this is the fact that China was ranked as low as the ninth largest investor in Belarus in 2011. The trade balance is also bad for Minsk. Its negative balance has been increasing year by year mainly as a consequence of imports of construction materials and machines as part of joint projects.

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The implementation of these projects also comes with its problems. In April 2012, Belarus withdrew from the contract concerning the modernisation of the Minsk airport because the Chinese partner had increased its value from US\$600 million to over US\$1 billion. Furthermore, **a number of aspects of co-operation with China are beginning to give rise to public resistance.** Residents of Smalyavichy near Minsk have protested against the construction of the industrial park, and the opposition and the independent media have made alarmist reports on the harm being inflicted on the country due to the increasing presence of Chinese capital. A consequence of this is that the Chinese issue is becoming an element of the dispute between the government and the opposition in Belarus.

⁴ Mainly between 2005 and 2010.

⁵ Data from the Embassy of the Republic of Belarus in China <http://china.mfa.gov.by/rus/relations/trade/>

Minsk's motivation in activating its contact with China was driven by the desire to absorb the Chinese loans which would allow Lukashenka to partly stabilise the bad macroeconomic situation in the country and help promote Belarusian goods on the Chinese market. In turn, it is hoped that close political co-operation will improve Lukashenka's image at home and the image of Belarus on the international arena, and also to make it possible to get better prices from Russia in the process of privatisation of Belarusian companies. Although China has been making efforts to buy the Belarusian company Belkali⁶ (which provides approximately 15% of global supplies of potash fertilisers), Lukashenka does not seem ready to sell this company at present. Moreover, only 25% of the shares (worth, according to Minsk's estimates approximately US\$7 billion) would be offered for sale, and also India and the Russian company Uralkali have declared an interest in the acquisition of this stake. China is not

⁶ Belkali is a strategic Belarusian company and the largest (along with the petrochemical sector) generator of foreign currency income (US\$3.2 billion in 2011). China, along with India and Brazil, are among the largest purchasers of its products.

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interested in purchasing any other assets in Belarus, seeing giving loans on governmental guarantees as a safer and more profitable form of co-operation. Although these loans have contributed to maintaining the unemployment rate at a low level, which is preventing public dissatisfaction from growing, in the longer term they will not help the Belarusian economic model to become efficient. The loans from China have been granted to Belarus for specific

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Ukraine: China as an element of the game with Russia and the EU

The policy of activating relations with China was commenced by President Viktor Yanukovich, who went on an official visit to China in September 2010. This was the first trip of a Ukrainian president to China in seven years. As a result of this, Beijing offered Ukraine a credit line worth US\$4 billion. In turn, in June 2011, Kyiv – along with Moscow and Astana – was among the places which the Chinese leader, Hu Jintao, visited during his Eurasian tour. A strategic partnership agreement and seven co-operation agreements which envisage the implementation of joint infrastructural projects totalling approximately US\$3.5 billion were signed during the meeting.

The development of more active relations with China is the main element of the concept for diversifying foreign policy and opening Ukraine up to emerging economies. This is so for several reasons. One of these is the concept of economising foreign policy, i.e. supporting economic co-operation by Ukrainian diplomacy; this is being promoted by the Viktor Yanukovich administration. The second factor is Kyiv's political relations with its two key partners – Russia and the European Union – which have been deteriorating since 2011. Given the growing political and energy pressure from Moscow and criticism from Brussels for the repressions applied to the political opposition, the Ukrainian government has decided to intensify contact with Beijing, who neither wishes to restrict its sovereignty, nor makes loans dependent on the improvement of the democratic standards.

Kyiv also sees its co-operation with Beijing as a 'driving force which will accelerate modernisation reforms.'⁷ In 2011, China was Kyiv's third largest trade partner, with a share of 3.2% in Ukrainian exports and 7.5% in imports. In recent years the economic co-operation between Ukraine and China has been developing rapidly, and trade volumes have been growing

⁷ See: Andri Yermolayev, director of the National Institute for Strategic Studies, a support agency to the President of Ukraine http://www.niss.gov.ua/public/File/2010_table/0901_sten.pdf

(see Appendix, Table 1), although its structure is unfavourable for Ukraine. This country exports mainly iron ores to China (almost 80% of exports), and imports predominantly processed goods. Only two of the seven planned joint projects have been started to date; their total value is less than US\$1 billion. These are: construction of a fast railway line to connect Boryspil airport with the capital city; construction of a fragment of the ringroad around Kyiv and the infrastructure around the airport; and modernisation of the state-owned Melnykov mine in Lysychansk. Additionally, China and Ukraine have expressed interest in implementing other projects (see Appendix, Table 2), including the constructions of reloading infrastructure premises in Odessa and Yevpatoria and the extraction of oil and gas in the Ukrainian part of the Black Sea shelf, and also obtaining the technologies for the construction of airplane engines from Antonov and Motor Sich companies⁸. **Co-operation in the area of technology** commenced already during Leonid Kuchma's second term as president (1999–2004), the results of which include the creation of three Chinese-Ukrainian technology parks in China (in Jinan and Harbin) and the Paton Electric Welding Institute. China has also shown interest in technologies in such areas as: materials science, electrodynamics, thermal physics, machine construction and pharmacology. A separate area of Chinese engagement in Ukraine is **military co-operation**. Due to the embargo on arms trade with China applicable in the EU, Beijing is searching for opportunities to obtain some Soviet technologies which Ukraine has. Beijing's main goal is to acquire the licences and/or technical documentation not always following official channels. Kyiv also benefits due to Russia's cautiousness in selling its weapons to China. In 1998, China bought the unfinished Soviet aircraft carrier Varyag from Ukraine for US\$20 million. This was to be used for non-combat purposes. However, this ship, now named Shi Lang, became part of the

equipment of the Chinese army in 2011. Some of the equipment and weapons used in this ship come from Ukraine, such as the J-15 carrier-based fighter aircraft, which have been constructed on the basis of the pre-production version of the Russian Su-33 obtained in Crimea. In 2009, after several years of fruitless negotiations with

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Russia, China and Ukraine made a deal worth US\$315 million, under which four Zubr class hovercrafts, including technical documentation, were sold⁹.

The existing and planned joint initiatives reveal the main areas of China's interest in Ukraine. China wants to implement long-range projects in the areas of energy, transport, agriculture, and technology. However, the Ukrainian government has shown low efficiency in using the Chinese loans and attracting direct investments (their level is at approximately US\$20 million). The growing trade volume is mainly an effect of Chinese activity and not of Ukrainian efforts. At the same time, Kyiv is presenting its co-operation with China in the media as an example of the success of its foreign policy and a method for expanding its room for manoeuvre on the international arena.

Moldova: China as a promising outlet

In comparison to Ukraine and Belarus, Moldova's relations with China are characterised by significantly lower dynamics of meetings at the political level and a very high negative trade balance (see Appendix, Table 1). In July 2009, the Chinese company COVEC offered a **US\$1 billion loan** for the implementation of infrastructural projects to Moldova, which was then governed by the Communist Party. However, according to unofficial information, this offer was rejected due to pressure from the IMF. This was because the IMF makes the availability of its loans dependent on economic reforms, while China does not make such requirements.

⁸ Motor Sich supplies AI-222 engines for the Chinese aircraft L-15; China is also interested in purchasing the licence. <http://www.kommersant.ua/doc/1504478>

⁹ It is not known whether the transaction has been effected. An accident happened in June 2011 at the time of the launch of this hovercraft at the Ukrainian shipyard.

Sang Guowei, the deputy speaker of the Chinese parliament, visited Chisinau in September 2011, and Prime Minister Vlad Filat had visited Beijing one year earlier. During that visit, the Moldovan prime minister managed to obtain a low-interest loan of US\$62 million from SinoHydro for the modernisation of 50 km of roads in Moldova. However, the main goal of the talks with Prime Minister Wen Jiabao was **to increase supplies of wine industry products to the Chinese market**¹⁰.

In the area of politics, the present Moldovan government is not putting China forward as a strategic partner and is not willing to play the Chinese card in relations with Brussels and Moscow. The main reasons for this are Chisinau's good relations with the EU and the pro-Western policy of the Alliance for European Integration, which is governing the country. The government in Chisinau is focused primarily on the economy and sees China as an outlet for its goods.

Conclusions

- The synergy of economic and geopolitical factors seen over the past few years has caused higher mutual interest between Eastern European countries and China. However, while **China desires to safely invest part of its financial surplus in these countries in the form of loans**, Ukraine and Belarus are trying to use their co-operation with China also in the area of politics, both domestically and abroad.
- The efficient co-operation of Ukraine, Belarus and Moldova with China can be a valuable addition but not an alternative to their political and economic relations with Russia. China does not intend to offer support to these countries in their dealings with Moscow, nor will it infringe upon the key Russian areas of interest: it is not investing in the energy sector, not buying important companies, and not interfering with foreign policy in these countries. Moscow and Beijing have common strategic interests, both bilateral and in global politics and these are more important for both parties than their competition in certain areas.
- **The Chinese engagement in Eastern Europe does not offer real competition to the political and economic significance of the EU in this region.** The pro-Chinese accents heard increasingly clearly in the statements of Ukrainian politicians over the past two years should be treated as one of the consequences of Ukraine's deteriorating relations with the EU. Such statements have been aimed at demonstrating to Brussels that Kyiv is considering a different model of development than the one proposed by the EU, and a different source of financial aid. They are also intended at diminishing the significance of the crisis in relations with the EU in the eyes of voters.
- From among the countries in this region, Belarus has the closest relations with China. One manifestation of this is the multi-billion dollar credit line made available to it by China. In the area of politics, this is intended to help the government in Minsk to emphasise the country's sovereignty on the international arena, as seen from both the domestic perspective and by foreign actors, mainly Russia. However, in the area of economy, **the loans from China will not replace the possible stabilisation loans from the IMF or the World Bank which are necessary to balance the budget and repay the foreign debt and which will be granted on condition that reforms are carried out.** The Chinese credit lines must be used for the implementation of specific projects and not to satisfy the current needs of the state.
- The availability of the Chinese loans may contribute to the modernisation of selected pieces of infrastructure in Ukraine, Belarus and Moldova. However, in the longer term, this is causing an increase in imports from China, including of machines. This is weakening the heavy industry sector in these countries, increasing the level of their debts and worsening their negative foreign trade balance.

¹⁰ This goal has been met: exports of Moldovan wine to China were more than seven times as high in 2011 in comparison to the preceding year.

APPENDIX

Table 1. Goods trade of Ukraine, Belarus and Moldova with China (US\$ billions)

Year	2010			2011		
	Value	Negative balance	% of total trade volume	Value	Negative balance	% of total trade volume
Ukraine	6.0	3.3	5.4	8.5	4.1	5.6
Belarus	2.1	1.2	3.5	2.8	1.5	3.2
Moldova	0.322	0.317	5.9	0.4	0.395	5.4

Table 2. Ukraine – the largest agreed projects with the participation of Chinese capital, the implementation of which has not yet begun

Project	Value (US\$)	Chinese partners
The construction of the gas power plant, with a capacity at 750–900 MW, in Shcholokino (Crimea)	800,000 – 1.5 billion	Loan – Exim Bank of China Contractor – China's Machinery Industry Sees
The construction of twenty granaries (50,000 tonnes each)	n/a	Loan – Exim Bank of China Contractors – Sinolight and China National Machinery & Equipment Import & Export Corporation
The modernisation of the potash fertiliser factory in Kalush	n/a	Wuhan Engineering Co., Ltd

Table 3. Belarus – the largest agreed projects with Chinese capital participation, the implementation of which has not yet begun

Project	Value (US\$)	Chinese partners
The Chinese-Belarusian Industry Park (8,000 ha, Chinese and other foreign investors, 50 years of tax benefits)	US\$5-6 billion within 15 years	Loans and technologies from China No precise data available
The construction of the cellulose factory in Svetlahorsk	US\$654 million	Loan – Exim Bank of China Contractor – China CAMC Engineering Co., Ltd.
The construction of additional blocks at the water power plants in Biaroza and Lukoml	US\$ 634 million	Loan – Exim Bank of China Contractor – China Machinery Engineering Corporation (CMEC)
Repair of the road between Zhlobin and Homel	US\$340 million	Loan – Exim Bank of China Contractor – China Road and Bridge Corporation



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