Serbia's state-owned utility Elektroprivreda Srbije (EPS) is building a new 350 MW lignite plant at Kostolac in the country's north-east, alongside two already existing units. This is the second phase of a project implemented by the China Machinery Engineering Corporation (CMEC) and financed by the China Export- Import Bank. The first phase, for which a USD 293 million financing contract was signed between the Government of the Republic of Serbia and China Exim on 29 December 2011, consisted of the modernisation of the existing units, the construction of a desulphurisation system, a landing dock on the Danube and an associated railway infrastructure.

The over-reliance of SEE on lignite coal is a reality that renders EU requirements for transition to cleaner forms of energy a complex endeavour. In this regard, the involvement of Chinese companies in the regional energy sector appears to pander to the Balkan states' questionable commitment to sustainability by enabling "dirty" energy projects – which Western funders are not willing to support any longer. The Kostolac coal power plant in Serbia offers a useful case to examine the impact of Chinese capital in delaying transition to cleaner forms of energy by enabling the perpetuation of the host state's political preference for carbon-based energy production.

The Serbian government signed an agreement with CMEC for the construction of the new unit in November 2013. No tender procedure took place because the Chinese and Serbian governments had signed an intergovernmental agreement in 2009 which exempts joint projects from public tender obligations. Following the signing of the commercial agreement with CMEC, a second, USD 608 million loan was agreed between the Serbian government and China Exim in December 2014 for the new unit and the expansion of the Drmno open cast lignite mine, whose annual production would increase from nine to twelve million tonnes.

Preparations on the Kostolac project began in January 2015, when the Serbian parliament ratified – in a fast track procedure designed to minimise opposition scrutiny – the second loan agreement with China Exim. Since then, the project has been dogged by numerous irregularities. First, the Serbian government took the loan on behalf of its state-owned utility EPS, raising issues of compliance with its state aid obligations under the Energy Community Treaty. Second, the feasibility study summary left out carbon costs on the assumption that they would be covered by the state. In practice, however, state aid rules that apply to Serbia as a signatory to the Energy Community Treaty forbid this kind of

payment. At the same time, the project's sensitivity analysis, which does include carbon costs, leaves no doubt that even a low CO2 price is enough to render the plant uneconomic. Lastly, with the European Union updating its legislation governing industrial emissions in November 2017, Kostolac B3 would now be obliged to adhere to emissions limits stricter than those set in the EIA decision from October 2017. This means that should Serbia continue towards EU accession, Kostolac would already be saddled with expensive retrofit costs necessary to bring the plant in line with EU standards.

Although the Serbian prime minister announced the completion of works at the Kostolac B1 and B2 desulphurisation units in August 2017, news reports mentioned that the issuing of operating permits was still pending. There is no publicly available information to this day regarding the existence of an operating permit, which raises the question of how the Chinese financier and contractor can ensure that all the legal obligations in the host country are adhered to. Also, according to eyewitness reports, the desulphurisation system seemed to be inoperative more often than not. Following these accounts, the Serbian Centre for Ecology and Sustainable Development (CEKOR) requested the Environmental Inspectorate's intervention. In its response, the inspectorate stated that

At the time of the previous inspection in November 2017, it was established that the desulphurization unit was in a test phase in March and April 2017, after which it did not work, since the construction of the landfill for the gypsum, which is created in the operation of this plant, has not been completed.

This raises concerns regarding both the contractor and the investor's ability to manage the project successfully and efficiently.

Apart from the irregularities mentioned above, the project comes with significant environmental costs. If the project is completed, the village of Drmno, where a core group of locals are requesting to be resettled, would become cut off from the rest of the world, having the Kostolac B power plant complex to the north, the huge Drmno opencast mine to north-east, east and south and to the west, a new dock on the Danube, where equipment for the new unit will be imported. Many locals are experiencing damage to their houses because of the mining operations which drain underground water and cause the soil to sink, but also due to vibrations from heavy machinery transiting through the village or operating too close to their houses. Most of the farmland in the village area has already been bought up by EPS to ensure that its mine expansion plans can go ahead without opposition. Ironically, locals have no job opportunities apart from the same company whose mining operations are destroying their houses and polluting the air. During the tragic floods that hit the Balkans in 2014, the Kostolac B power plant narrowly avoided being flooded thanks to

the tireless work of plant workers, firefighters and civilian volunteers. While their efforts were successful – unlike at Kolubara and Nikola Tesla plants, which were seriously affected by the floods – later that year a separate flooding incident saw unit A2 at Kostolac closed for several days, while the Drmno mine was also partially flooded.

Similar to Piraeus, assessing the environmental impact is a key aspect in the Kostolac case. The first EIA for Kostolac B3 was approved in December 2013 but it did not include an analysis of transboundary impacts (the site is just 15 km from the Romanian border) and suffered from numerous other deficiencies. It was therefore challenged in the administrative court in Serbia by CEKOR and at the Espoo Convention Implementation Committee by Bankwatch Romania. In March 2015, the Espoo Convention Implementation Committee noted that the construction of a unit at the Kostolac lignite power plant was an activity listed in Appendix I to the Convention and that the likelihood of a significant adverse transboundary impact could not be excluded. Therefore, the Committee asked Serbia to comply with its obligations under the Convention and to notify Romania about the EIA. This was the first time that the Committee opened an initiative related to cross-border impacts of a coal fired power plant. In June 2016, the Serbian administrative court ruled that CEKOR's arguments were valid and that the decision to approve the environmental assessment should be revoked. By this time, however, the original decision had already expired and a new environmental assessment had to be carried out.

The new EIA process took place in 2017, included transboundary consultations, and was approved in September. However, it still failed to ensure compliance with updated EU pollution standards, the so-called LCP BREF, and didn't address the concerns of residents of the Drmno regarding their health and property damage. Therefore, CEKOR again challenged the decision in court. In September 2018, a complaint was submitted to the Energy Community Secretariat by CEE Bankwatch and CEKOR, alleging Serbia's non-compliance with the EIA Directive for the Drmno mine expansion. Consequently, the Espoo Convention Implementation Committee re-opened the investigation into the mine expansion being carried out without a transboundary impact assessment.

To sum up, despite economic, environmental and health concerns, the Serbian government seems adamant to go ahead with this project, signalling a high level of political will that overrides questions about economic feasibility and sustainability. Kostolac B3 is referred to as the country's most important energy infrastructure project in the last thirty years and is listed as a priority in the implementation programme for the country's energy strategy. While financing and construction are done by Chinese actors, the project is chiefly driven by unwavering domestic political commitment. Yet at the same time, Western institutional

lenders have not followed such a blasé approach to satisfying domestic, European and international regulations and norms. They enforce transparent environmental, social and access to information policies, which facilitate timely social scrutiny even in the face of overwhelming host state support, as the cessation of coal financing by the European Investment Bank, the European Bank of Reconstruction and Development and the World Bank clearly demonstrates. In contrast, Chinese infrastructural projects are governed by the 2009 bilateral cooperation treaty, which tasks the host state with providing administrative support. The pre-contract on the project's implementation states that Serbia's national power utility will provide all necessary documentation, but there are no provisions beyond this general and vague commitment, no references to the project's environmental sustainability aspect, nor are they present in the financing agreement between the Serbian government and China Exim bank. This lack of compliance together with oversight mechanisms means the Chinese investor has to blindly trust the host state to arrange for the legality of the project. Yet without the necessary instruments of transparency, oversight by domestic civil society and regional regulatory frameworks is difficult, leaving such projects vulnerable to intended and accidental malpractice and the breaking of rules and norms.
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