

CENTRAL ASIA UNDERGOING A REMARKABLE TRANSFORMATION: BELT AND ROAD INITIATIVE AND INTRA REGIONAL COOPERATION

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SUMMARY

- In Central Asia, China has actively invested in infrastructure under the Belt and Road Initiative (BRI)¹ in recent years, pushing forward the development of new logistics routes, gas and oil pipelines, and power grids. Economic reforms and a ‘good-neighbor’ policy pursued by the Uzbek president have had positive impacts on Central Asia as a whole, enhancing intra-regional dialogue and corporation.
- On the other hand, some negative impacts of the BRI have surfaced, such as mounting indebtedness by Central Asian countries to China and a lack of transparency. The BRI is facing opposition by local residents in the region who have low confidence in their governments.
- Pursuing a balanced diplomacy, Central Asian countries have high expectations for Japan as well. Japan may find business opportunities, such as the operation and maintenance of infrastructure developed under the BRI and “quality infrastructure export.”

SEISMIC CHANGES IN CENTRAL ASIA

1) Development of the BRI

In recent years, China have been developing infrastructure in the five Central Asian countries — Kazakhstan, Kyrgyzstan, Turkmenistan, Tajikistan, and Uzbekistan (Figure 1) — under the BRI. The region is being transformed by China’s infrastructure investment, with the launch of railway logistics routes connecting Central Asia and Europe, and the development of highways, oil and gas pipelines, transmission networks, and optical fiber cables.

Figure 1: The Five Central Asian Countries



¹ The Belt and Road Initiative (BRI) is a global development strategy adopted by China to connect Asia with Europe and Africa. It is known as the One Belt One Road Initiative in Japan.

The Silk Road Economic Belt, the overland part of the BRI, was announced by Chinese President Xi Jinping in September 2013 in Kazakhstan. Xi Jinping suggested that it will “improve road connectivity [...] open up a major transportation route connecting the Pacific and the Baltic Sea [...] and build] a transportation network connecting East Asia, West Asia and South Asia.”² The BRI provides opportunities for Central Asia, which serves as a gateway connecting China with West Asia and Europe, to build infrastructure with China's financial assistance, thereby reducing logistics costs, expanding trade, and attracting foreign investment.

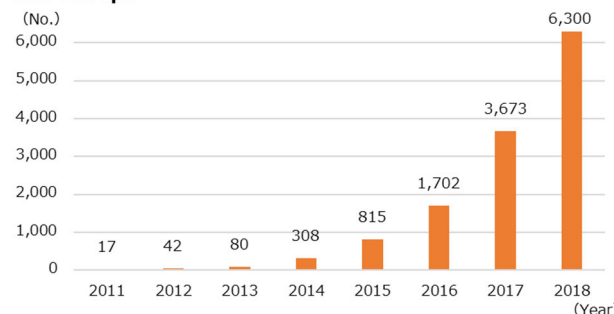
The New Eurasian Land Bridge, a rail route connecting China with Europe via Kazakhstan, is attracting particular attention as a major infrastructure project in the region (Figure 2). The number of freight trains between China and Europe increased sharply from 17 in 2011 to 6,300 in 2018 (Figure 3). The volume of transport on the route exceeds that on the Eurasian Land Bridge, which runs through Russia along the Trans-Siberian Railway. International freight companies, including Nippon Express, are involved in rail transport services on the route. It is expected that rail transport between China and Europe will increase as a “third means of transport” that is cheaper than air transport and faster than maritime transport. Between China and Europe, the standard 1,435-mm gauge is used, whereas in Central Asian countries, a 1,524-mm gauge is used. The difference in gauge means containers need to be transferred from one train to another. Khorgos in Kazakhstan has recently been attracting attention in Japan for its massive development as a dry port operating as a center for transshipment. Railways and roads from China to Iran and Turkey through Central Asia are also being developed. Surrounded by China, Europe and the Middle East, Central Asia launched special economic zones, not to be regarded merely as a transit point. Central Asia is trying to attract investment in not only the transport and logistics sectors, but also the areas of agriculture, food processing, and textiles, in addition to mining, supported by abundant natural resources. Each country is making efforts to maximize the benefits gained from the BRI.

Figure 2: New Eurasian Land Bridge and other major international rail routes in Central Asia



Source: European Parliament, Connectivity in Central Asia

Figure 3: The number of freight trains between China and Europe



Source: Compiled by MGSSI based on data from Jakub Jakóbowski, Konrad Poplawski, Marcin Kaczmarek, The Silk Railroad and Xinhua News Agency

² https://www.fmprc.gov.cn/mfa_eng/wjdt_665385/zyjh_665391/t1078088.shtml

In the area of energy cooperation within the framework of the BRI, connectivity between China and Central Asia is being strengthened by new pipelines. An oil pipeline from Kazakhstan to China and three gas pipelines from Turkmenistan to China have been constructed so far. About 85% of China's total imports of natural gas in 2017 came from Central Asia, with Turkmenistan accounting for 76% of its total imports³, indicating that Central Asia is an extremely important region for China in terms of energy security.

2) Intra-regional dialogue in Central Asia

In Uzbekistan, President Islam Karimov, who had led the country for a quarter century from when it was still the Uzbek Soviet Socialist Republic, died in September 2016, and Shavkat Mirziyoyev took over as president. President Mirziyoyev drastically changed the closed economic model seen during Karimov's presidency and launched economic reforms, such as creating a series of special economic zones and liberalizing foreign exchange. The European Investment Bank (EIB) and the European Bank for Reconstruction and Development (ERBD) resumed their activities in the country. These economic reforms in Uzbekistan had a positive impact on Central Asia as a whole, encouraging traffic in goods and people and promoting trade in the region. In 2017, the trade volume between Kazakhstan and Uzbekistan increased by 32% year-on-year.

On the diplomatic front, President Mirziyoyev visited Tajikistan in March 2018 after 18 years of conflict over border issues, and the two countries signed agreements, including the reopening of the border and border checkpoints, abolition of visa requirements, and the resumption of flights between the two countries. Mirziyoyev said "(These) historic agreements are of great importance not only for our peoples, but for the entire region." Immediately after that, the first Central Asia Summit in 15 years was held at his suggestion, creating momentum for intra-regional dialogue. The president of Kazakhstan, Nursultan Nazarbayev, stated "In order to solve the problems of the Central Asian countries, we do not need to call a third party, we can solve all our problems by ourselves, and we meet for this," suggesting a trend toward solving problems in the region by themselves. At this summit, economic issues such as cooperation in the areas of trade, transport and communications were discussed. Amidst a growing intra-regional dialogue, the issue of dam construction in Tajikistan, which had long been a concern for the region, was of particular interest.

Water resource problems in Central Asia are nothing less than conflicts over the distribution of water in upstream countries: Tajikistan, Kyrgyzstan, and downstream countries: Uzbekistan, Turkmenistan, and Kazakhstan. The upstream countries relying on hydropower want to release more water in winter to generate hydropower, while the downstream countries relying on river water for agriculture oppose the idea because water shortages in summer have a direct impact on agriculture. In particular, the construction of the Rogun Dam, which started in the 1970s when Tajikistan was part of the Soviet Union, has been disrupted for nearly 40 years by protests from Uzbekistan, the civil war and flooding in Tajikistan. However, after the inauguration of President Mirziyoyev, who sought to improve relations with neighboring countries, Uzbekistan changed its opposition to the construction of the dam. In November 2018, Tajikistan launched the first station of the dam. The launch of the Rogun Dam also has symbolic significance as an achievement made through intra-regional dialogue in Central Asia.

2. NEGATIVE ASPECTS OF THE BRI IN CENTRAL ASIA

1) The risk of debt distress to China

Recently, there has been growing criticism of China's "debt diplomacy," particularly in the US, as seen in the remarks made by US Deputy President Mike Pence regarding the Trump Administration's policy on China in October 2018. Pence criticized China, citing the example of a Sri Lankan port. No matter whether or not China

³ "Part 1, Chapter 2: Economic trends and external economic policies in major countries/regions" White Paper on International Economy and Trade 2018: Expanding digital trade and Rise of emerging and developing economies, Development of free, fair and high-level trade rules. Ministry of Economy, Trade and Industry, 2019, P.131

is intentionally leading some countries into a "debt trap" to gain access to infrastructure management and resources, there is a growing concern over the mounting debt owed to China among the general public in Central Asia, particularly in Kyrgyzstan, which has moderate restrictions on media freedom. China accounted for 45.3% of Kyrgyzstan's external debt (May 2019) and 51.1% of Tajikistan's external debt (July 2016) (Figure 4). According to a report released by the US Center for Global Development in March 2018, these ratios could increase as the BRI progresses. The report evaluated the debt levels of the 68 countries hosting BRI-funded projects, considering each country's total debt to China as a percentage of total public external debt, and found that in eight of those countries, including Kyrgyzstan and Tajikistan, the BRI appears to create the potential for debt sustainability problems, if all the planned projects are implemented (Figure 5)⁴. Since China is neither a member of the OECD Development Assistance Committee nor the Paris Club, the country does not disclose its investment and development policies, as well as data on its capital in a transparent manner, and does not coordinate with other donors, sidestepping international norms on loan management. These factors account for the growing concerns over debt sustainability.

Figure 4: Central Asian country's debt to China

(100 million USD)

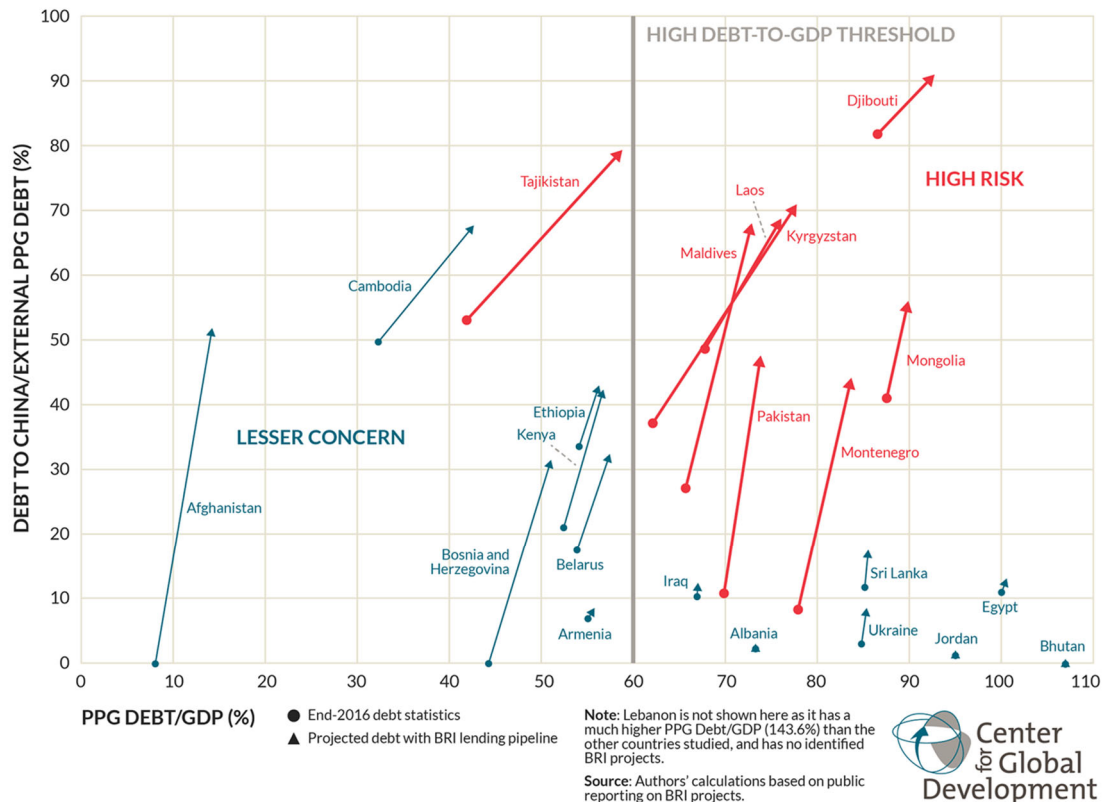
	Public external debt	Debt to China	Debt to China as a % of public external debt
Kazakhstan	140.189	12.497	8.9%
Kyrgyzstan	37.830	17.146	45.3%
Tajikistan	22.764	11.626	51.1%

Note 1: No data is available for Turkmenistan and Uzbekistan

Note 2: Kazakhstan as of April 1, 2019, Kyrgyzstan as of May 31, 2019 and Tajikistan as of July 1, 2016

Source: Compiled by MGSSI based on data from each country's central bank and finance ministry

Figure 5: Immediate Marginal Impacts of BRI Project Lending Pipeline



Source: Center for Global Development

⁴ John Hurley, Scott Morris and Gailyn Portelance. "Will China's Belt and Road Initiative Push Vulnerable Countries into a Debt Crisis?". Center for Global Development. <https://www.cgdev.org/blog/will-chinas-belt-and-road-initiative-push-vulnerable-countries-debt-crisis>

2) Challenges for the BRI in Central Asia

The BRI faces various challenges besides debt issues. The US think tank CNAS points out seven challenges, including (1) erosion of national sovereignty, (2) lack of transparency, (3) unsustainable financial burdens, (4) disagreement from economic needs, (5) geopolitical risks, (6) negative environmental impacts, and (7) significant potential for corruption⁵. Among them, particular attention should be given to (4), (2) and (7) in considering the BRI in Central Asia.

With respect to (4) disagreement from economic needs, the problem is that China provides loans to countries under the condition that they use Chinese technologies and hire Chinese workers. Having a high unemployment rate, Kyrgyzstan and Tajikistan mainly send migrant workers to Russia. According to the World Bank, personal remittances in 2017 accounted for 32.9% of GDP in Kyrgyzstan and 31.3% in Tajikistan, meaning that the economies of both countries are supported by remittances from migrant workers. This figure demonstrates that job creation is an urgent issue for both countries. The fact that China does not contribute to their employment and job creation issues through infrastructure development is one of the reasons why China's investment is not necessarily welcomed by these countries.

Nos. (2) lack of transparency and (7) significant potential for corruption are also challenges facing Central Asia. Central Asian governments are also reluctant to disclose information. Their lack of transparency on debt and on China's BRI activities, as well as the prevalence of corruption⁶ and low confidence in governments and officials, both of which are particularly pronounced in Central Asia, has sparked protests in the region. In Kazakhstan in March 2016, the government announced a new bill that would extend a permit to lease agricultural land to foreigners from 10 years to 25 years, which sparked massive protests by local residents who feared that the Chinese would take over the land. As a result, the land code amendments were put on hold and Prime Minister Karim Massimov was removed from his post. Kyrgyzstan launched a project to modernize the country's power plant with a Chinese firm, financed with a 390 million dollar loan from China. However, an incident at Bishkek's main power plant in 2018 caused a five-day blackout. The Kyrgyzstan people's anger was directed at the Chinese firm and power plant officials who were doing sloppy work, resulting in massive protests. Subsequently, the Prime Minister and former President were arrested for bribery allegations surrounding the project. In 2019, the media reported a series of protests in Kyrgyzstan against the growing influence of China, urging the authorities to deport illegal Chinese migrants and to stop granting them citizenship, as well as to investigate how the country's financial borrowing to China is being used.

3. CENTRAL ASIA'S EXPECTATIONS TOWARD JAPAN AND JAPAN'S BUSINESS OPPORTUNITIES IN THE REGION

1) Central Asia's balanced diplomacy

Russia, which views Central Asia as its own "sphere of influence," is also wary of China's growing influence in the region. The Eurasian Economic Union (EEU), led by Russia and comprised of former Soviet states, aims to maintain the influence of Russia by competing with the influence of the EU in Europe and China in Central Asia. "It (Russia) has become noticeably anxious about China's expanding footprint, which has graduated quickly from domination of the local retail trade to large-scale investment in energy and infrastructural projects."⁷ says Bobo Lo, an expert on China-Russia relations. This is why Russia is trying to take Kyrgyzstan and Tajikistan

⁵ Daniel Kliman, Rush Doshi, Kristine Lee and Zack Cooper. "Grading China's Belt and Road". Center for a New American Security. <https://www.cnas.org/publications/reports/beltandroad>

⁶ According to the Corruption Perceptions Index 2018 by US Transparency International, which ranks 180 countries by their levels of corruption, Kazakhstan ranked 124th, Kyrgyzstan 132nd, Tajikistan 152nd, Turkmenistan 161st, and Uzbekistan 158th. The level of corruption is typically high in the five Central Asian countries.

⁷ Bobo Lo. *Russia and the New World Disorder*. London, Chatham House, 2015, p126

into the EEU and prevent China from expanding its influence in Central Asia. Among the five Central Asian countries, the EEU members are only Kazakhstan, which suggested the idea of creating a union in 1994 and was a member of the Customs Union of Belarus, Kazakhstan, and Russia, the predecessor of the EEU, and Kyrgyzstan, which joined the EEU in 2015.⁸ There seem to be many reasons why the other three countries have no urgent need to join the EEU, and one of them is the balanced diplomacy shared by Central Asian countries. This means that Central Asia, which borders China and Russia and is geopolitically important for these major powers, recognizes that in order to maintain its independence and sovereignty, it is necessary not to rely on either of them, but to develop a balanced relationship with many partner countries. Turkmenistan, having declared its permanent neutrality, refuses to join any regional alliances. This is one side of the balanced diplomacy unique to Central Asia.

Russia and China signed an agreement that coordinates the EEU and the BRI in 2015, but Central Asia was not informed of the agreement in advance. The agreement states that the Russian Ministry of Foreign Affairs and the Chinese Ministry of Foreign Affairs are responsible for coordinating the cooperation between the EEU and the BRI, but it does not mention anything about other EEU members and Central Asian countries, as well as the Eurasian Economic Community, which is the executive body of the EEU. Central Asian countries are not comfortable with the situation in which important matters are decided by Russia and China, and increase their expectations towards other partners, such as Japan, the EU, South Korea, and Turkey.

2) Business opportunities in Central Asia

According to a questionnaire survey targeting 310 officials and entrepreneurs from Kazakhstan and Kyrgyzstan conducted by Marek Johec from Nazarbaev University and Jenny Jenish Kyzy from National University of Singapore in 2017, Japan scored highest among “countries that are considered desirable in terms of providing foreign investment,” followed by Germany, Switzerland, South Korea, the United Kingdom, the Netherlands. They have high expectations towards Japan, because the country “has advanced science and engineering and functioning markets/market institutions, followed by low corruption and functioning democracy.”⁹ Japan has provided aid and assistance to Central Asian countries for a long time, especially for human resource development, and this is one of the reasons that they share favorable sentiments towards Japan.

However, high expectations and favorable sentiments towards Japan may not necessarily lead to immediate business opportunities. In the World Bank’s Doing Business 2019, which provides objective measures of business regulations and their enforcement across 190 economies, Kazakhstan ranked 28th, but the other Central Asian countries ranked low, with Kyrgyzstan 70th, Uzbekistan 76th, Tajikistan 126th, and Turkmenistan being excluded from the ranking. Notably, “Getting Electricity” (with Kazakhstan 76th, Kyrgyzstan 164th, Tajikistan 173rd) and “Trading across Borders” (with Kazakhstan 102th, Kyrgyzstan 70th, Tajikistan 148th, Uzbekistan 165th) seem to be the main problems in doing business with them.

As discussed, infrastructure development and intra-regional cooperation under the BRI have created an unprecedented environment in Central Asia, which raises expectations towards Japan and may open up new business opportunities. As Johannes F. Linn and Leo Zucker says “Despite the overwhelming evidence that infrastructure maintenance is critical, recent studies on infrastructure, connectivity and the BRI often neglect the

⁸ As the EBRD points out that “the main benefit of the EEU accession so far has been the equal treatment of Kyrgyz Republic citizens, when employed in another member country of the EEU,” it is believed that Kyrgyzstan joined the EEU to improve the working and living conditions of its approximately 0.8 million migrant workers (unofficially 1.2 million in 2017). (H.Holzhaecker, D.Skakova, Kyrgyz Republic Diagnostic, May 2019, EBRD, p.11)

⁹ Marek Johec and Jenny Jenish Kyzy. “China’s BRI Investments, Risks, and Opportunities in Kazakhstan and Kyrgyzstan”. China’s Belt and Road Initiative and Its Impact in Central Asia. Marlene Laruelle ed., 2018, p.74

O&M dimension, and specifically the need to adequately maintain infrastructure assets,"¹⁰ there will be an increasing need for operating and maintaining infrastructure developed under the BRI. Amid the growing expectations towards Japan, there will be a certain demand for "quality infrastructure exports" from Japan to Central Asia, in accordance with the highest international standards, as a substitute for infrastructure investment by China. Japan and China have agreed to jointly invest in third country infrastructure development, with a smart city in Thailand as a key initial project. Japan is also investing in the modernization of the Atyrau refinery in Kazakhstan under a consortium with China. It would be worthwhile to consider partnering with Chinese firms that have a competitive advantage in Central Asia.

¹⁰ Johannes F. Linn and Leo Zucker, An "Inside-out" Perspective on the Impact of the Belt and Road Initiative in Central Asia and the South Caucasus: How to Maximize Its Benefits and Manage Its Risks, p.22, <http://www.emergingmarketsforum.org/wp-content/uploads/2019/02/An-Inside-out-Perspective-Compiled-2019-01-07-FOR-WEB.pdf>