

FOCUS

By Dominique Fruchter,
Economist for Caucasus, the CIS,
Western Balkans, Switzerland & Ukraine
based in Paris, France

Central Asia: is the *ménage à trois* with China and Russia sustainable?

Central Asia¹ is both a partner and a trade gateway for China and Europe. It is located on two branches of the New Silk Road. Despite criticism, China is the most involved in the development of Central Asian corridors. This deployment is not obvious given the competition from other routes and poor regional cooperation. While Russian influence remains significant through expatriate remittances, its military bases, and culture, it is being supplanted by China in economic matters.

Central Asia is both a partner and a trade gateway for China and Europe

The region's countries' foreign trade in goods accounts for a significant share of their gross domestic product²: 57% and 42% respectively for the main economies of Kazakhstan and Uzbekistan, but up to 85% and 60% respectively for the smaller ones of Kyrgyzstan and Tajikistan. The main exports are hydrocarbons, gold, silver, copper and other minerals, steel, aluminium, cotton and cereals. They purchase capital goods, vehicles, petroleum products, steel, medication, and polymers.

The main partners of the region³ (**Chart 1**) are the European Economic Area (25% of the region's trade), China (21%) and Russia (18%). Turkey, Kazakhstan³, South Korea, and the United States also rank high among the partners. As a result, and because of their isolation, the interest of the countries of the region in the Silk Roads and its projects does exist. But there is also interest from their partners, particularly from Europe and China. For

them, beyond their trade with the region, their bilateral trade can benefit from the implementation of new projects under the Chinese Belt & Road Initiative.

Central Asia is located on two Belt & Road routes

The Belt and Road initiative (B&R), launched by Chinese President Xi Jinping in Kazakhstan in 2013, aims to promote the development of a network of connectivity and cooperation between China and Western Eurasia through loans and direct investment. This should notably enable it to secure its energy and raw material supplies, and develop new, faster and cheaper routes for its main export and import flows. At the same time, it should also promote the development and stability of the regions covered, counter the development of radical Islamism and its expansion on its territory, and find outlets for construction activity with overcapacity on its domestic market. China is the largest provider of funding, with the World Bank and financial institutions in partner countries providing few resources in this context. Private financing may also be used. At the beginning of 2019, the initiative involved 130 countries representing 41% of world GDP and 49% of trade⁴.

1 - In the context of this study, Central Asia includes Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan.

2 - 2018 data extracted from Intracen (joint WTO/UN agency) and the World Bank (on April 1, 2019).

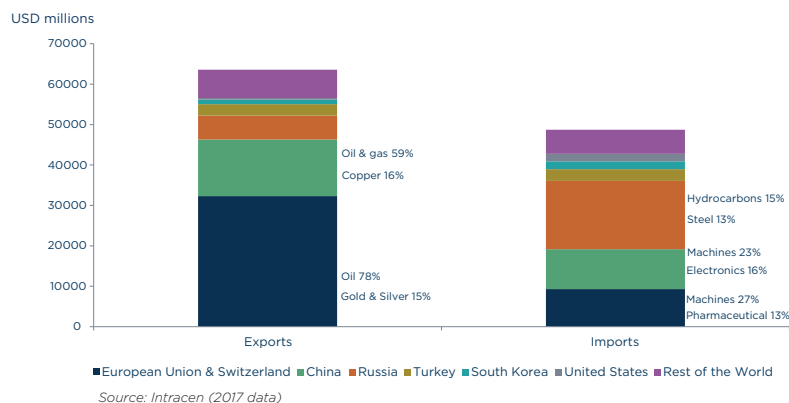
3 - Kazakhstan conducts 40% of its trade with the EEA.

4 - Kohli, H. S. & Zucker, L., 2019. An economic perspective on the Belt and Road Initiative: five years after its launch. *Emerging Market Forum*.

In Central Asia, this takes the form of direct investment and loans in research, exploitation and transport of hydrocarbons, extraction of gold, coal and other minerals, generation and transport of electricity, including hydropower, construction and modernisation of roads and railways, logistics centres, telecommunications, agriculture and tourism⁵. Although comprehensive data on completed or ongoing achievements and projects are patchy in the absence of an official list (less true for Kyrgyzstan and Uzbekistan), it appears that China has invested more than USD 4 billion in Turkmen gas, for which it is almost the only outlet and which covers 40% of its needs, particularly through the gas pipeline linking the two countries through Uzbekistan and Kazakhstan. China's investments in Kazakhstan, particularly in raw materials, are very significant, making it its main regional partner. The two countries have developed the dry port of Khorgos⁶ on their border, making it a key road and rail transit centre in a country that is a geographical gateway, both for access to the region and for transit between China and Russia/Europe.

However, a majority of the investments made, notably in transport routes, correspond to projects that pre-date the B&R, sometimes initially launched by the countries of the region and supported by international organizations, and which have opportunely benefited from the NRS label. In addition, the infrastructure built so far in the region is relatively limited. Indeed, Central Asia (excluding Afghanistan and Mongolia) encompasses only five countries, hosts only two of the six main land corridors and, of course, none of the two maritime routes listed by the B&R⁷. Apart from Kazakhstan and Turkmenistan, which are highly dependent on hydrocarbons, the rapid growth of GDP (between 4% and 6% in 2019, according to Coface forecasts) starts from a still low level (GDP per capita below USD 7000⁸). Given the small populations of Turkmenistan (5.7 million inhabitants), Kyrgyzstan (6.3 million) and Tajikistan (8.9 million⁹), interest in the exploitation and transport of raw materials, as well as transit with the west of the continent, outweighs interest in local markets.

CHART 1
Foreign Trade of Goods in Central Asia



Chinese action is being criticized

The Chinese initiative is also disrupted by the presence in China of 1.5 million Kazakhs (especially in the northwest region of Xinjiang), as well as other Muslim populations (notably Uighurs) also present in Central Asian countries. These people are affected by China's policy of internment in "re-education"¹⁰ camps. In response to the rise of anti-Chinese sentiment among the Kazakh population, China has recently expelled Chinese nationals who also held Kazakh nationality to Kazakhstan. This feeling may also have been fuelled by the fact that China favours the employment of Chinese workers in the investments it finances in the region. Finally, the distribution between the two countries of the water from the Ili River that supplies Lake Balkhash and the Irtysh River is a matter of debate. In addition, recent demonstrations in Kyrgyzstan indicate a rise in anti-Chinese sentiment among the local population due to the growing presence of Chinese and the plight of the Kyrgyz in China¹¹.

In addition to the tropism in terms of employment, critics add that projects carried out within the framework of the B&R favour companies and imports from China. Moreover, since FDI and grants are very much in the minority when compared to loans, even at low interest rates², the projects lead to an increase in the external debt of the countries in the region. Indeed, at the end of 2018, Tajikistan's external debt (**Chart 2**) represented 76% of GDP and Kyrgyzstan's 84%. China's share accounted for about 30% of GDP for the latter, 16% in the public debt alone (half of the debt) of the former. These two countries have the highest debt burden due to the small size of their economies. Tajikistan has postponed the construction of the second unit of the Roghun hydroelectric power plant, and Kyrgyzstan has asked China to provide assistance - not a loan - for the continuation of a road construction project. For Turkmenistan, data is scarce, but commitments related to gas exploitation are certainly high. Depending on the source, the country's external debt varies from USD 9 billion to USD 11.6 billion, or 21-27% of GDP in 2017. In Kazakhstan, at the end of 2018, external debt represented 92% of GDP and 6.6% for the Chinese part alone. The size of the economy and its own resources linked to its status of hydrocarbon producer make it possible for the country to self-finance or use other sources of financing for the construction of the infrastructure provided for in the Nurlu Zhol programme, to which the BRI is subordinate. For Uzbekistan, external debt is half as high (48% of GDP) due to the recent opening of the economy, but it is progressing rapidly with the rapid development of infrastructure. China's share represents 10% of GDP.

Beyond the debt burden alone, the important thing is that the project benefits the country. From this point of view, but also from the perspective of operation and

5 - Finance, education, research and cooperation, although included in the initiative, are not very concerned.

6 - Mauk, B. 29 January 2019. Can China turn the middle of nowhere into the center of the world economy? *New York Times*.

Available at: <https://www.nytimes.com/interactive/2019/01/29/magazine/china-globalization-kazakhstan.html>

7 - Linn, J.F. & Zucker, L. 2019. An inside-out perspective on the impact of the B&R in Central Asia and the South Caucasus: How to maximize its benefits and manage its risks. *Emerging Market Forum*.

8 - World Bank data: 17993 for Kazakhstan, 26435 for Turkmenistan, 6865 for Uzbekistan, 3725 for Kyrgyzstan and 3195 for Tajikistan (2017, in current US dollars and purchasing power parity).

9 - UNCTAD 2017

10 - Bogusz, M. & Mariusz, M. 2019. OSW: Chinese-Kazakhstan agreements on oppressed group of Kazakhs

11 - Eshaliyeva, K. 2019. Is anti-Chinese mood growing in Kyrgyzstan? *Open Democracy*. Available at: <https://www.opendemocracy.net/en/odr/anti-chinese-mood-growing-kyrgyzstan/>

12 - Fourquin, M. 2019 Les nouvelles routes de la soie: essai d'évaluation. *CEPII*.

maintenance, the quality of governance appears to be decisive in the choice of projects. However, governance (Chart 3) still leaves much to be desired in several of the countries of the region. As Chinese loans and investments do not have to comply with World Bank and IMF criteria, China not being a member of the Paris Club of public creditors, the risk of an unfavourable cost/benefit ratio is significant.

The development of Central Asian corridors is subject to strong competition

While the development of new sources of raw materials in Central Asia, particularly energy, leaves little room for hesitation, the development of new transport routes that are uniquely for transit is not a given. First, there is competition from existing Indian Ocean shipping lanes, but also from air transport. Land transport (rail) between China and Europe via Central Asia is both more expensive (1.5 times more expensive, taking into account the subsidy paid by the Chinese provinces, which can reach 40% of the cost) and more than twice as fast (14 days instead of 40) than maritime transport¹². It is cheaper, but slower than air travel. This mode can therefore only satisfy certain types of goods that can be accommodated in this intermediate position. Secondly, it has to deal with the railways passing to the north through Mongolia, Manchuria, and Siberia, even if they are less direct. Moreover, within the region itself, several routes are possible, which is not without consequences, while all the countries of the region, because of their isolation in the middle of the continent, seek to reduce the very high cost of transport associated with their foreign trade. Thus, the corridor linking China and Europe through Kazakhstan and Russia, by far the most active and successful, does not favour the other Central Asian countries. On the other hand, the one linking China to the Middle East and Southern Europe via the Mediterranean serves, in addition to Kazakhstan, Uzbekistan and Turkmenistan. Its broadcasting capacity, particularly in Kyrgyzstan and Tajikistan, which are separated from China by high mountain ranges, is much stronger. But it requires the collaboration of third countries (Iran, Azerbaijan, Georgia, Turkey), as well as countries in the region that are still not used to working together. In addition, Kyrgyzstan and Tajikistan, and therefore the entire region, could benefit from an opening to India, Pakistan, Iran and the Indian Ocean via Afghanistan, if the latter's security situation and Indo-Pakistani relations improve. However, between 2007 and 2016, the share of rail freight between China and Europe increased from 0.5 to 2.1% and 200,000 containers are expected to pass through Central Asia in 2019.

Regional cooperation, still insufficient, has recently improved

Until recently, relations between Central Asian countries were tenuous, episodic and often stormy. All of them are united only within the Central Asia Regional Economic Cooperation Program (CAREC) created in 1997 under the aegis of China. The Eurasian Economic Union, initiated in 2005 by Russia, only includes, in the region, Kazakhstan and Kyrgyzstan, and operates at a minimum.

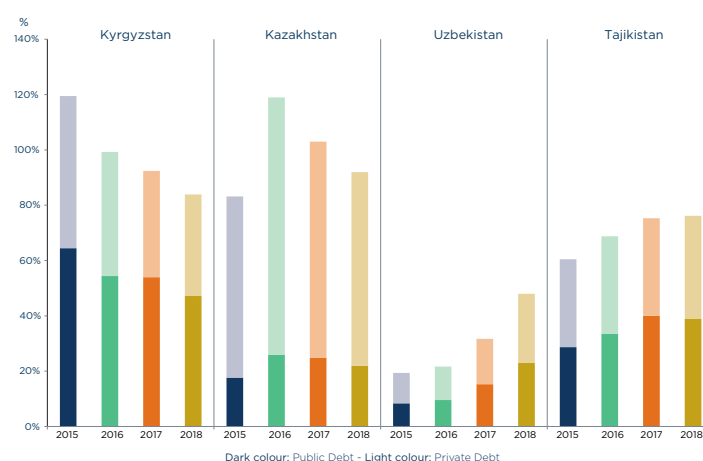
Border crossings are laborious and sometimes costly (corruption and bureaucracy). This is probably less the case for rail convoys, even if they are confronted with load breaks imposed by the difference in rail gauge between China, Central Asia/Russia, and Europe. The Uzbek policy of openness initiated in 2017, due to the country's central location in the region, seems to have caused a regional political and regional thaw. This has made it possible to resume trade and resolve disputes over water sharing and border entanglement in the Ferghana Valley, a very important issue for countries that are still very agricultural, for whom cotton cultivation is important, and who are counting on the development of their hydroelectric potential (Uzbekistan, Tajikistan and Kyrgyzstan). However, the improvement is fragile. Intra-regional trade is low (less than 1/10 of total trade¹³) and the problem of replenishing the Aral Sea has not yet been resolved.

Russia's presence in Central Asia remains significant, but is being supplanted by China in economic terms

Some Central Asian countries depend on remittances and transfers from their expatriates in Russia

Russia hosts about 4 million expatriates from Central Asia whose incomes fluctuate with the Russian economy, the value of the rouble, and the price of oil (thus, they fell by half between 2013 and 2016). Despite the imprecise statistics, remittances and transfers from these expatriates are important for Tajikistan (36% of GDP in 2018), Kyrgyzstan (37%), and Uzbekistan (13%). The labour markets of their economies, like that of Turkmenistan, are unable to absorb new entrants, of which there are many given the region's demographic dynamism: the population is growing at 1.5-2% annually. In addition, Russia is highly attractive due to its much higher standard of living and wages, and even if there is diversification towards Turkey, Kazakhstan and South-East Asia, particularly for Uzbeks, Russia remains largely in the lead for new expatriations.

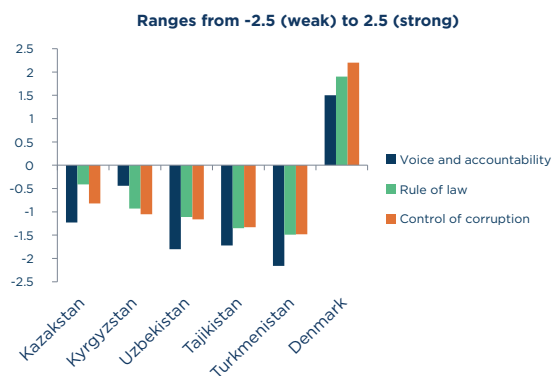
CHART 2
Public & Private external debt as a % of GDP



Source: Central Banks

Russian cultural influence remains despite the advantage given to local culture

Despite significant emigration to the motherland in the years following the break-up of the USSR, a large Russian minority (25% of the population) still lives in Kazakhstan. It is concentrated in the north and east of the country. In fact, Russian is widely spoken in the country, but also in Kyrgyzstan (Russians are said to represent a little over 10% of the population), where it is also an official language. Moreover, despite the rise of Chinese scholarships, the number of Central Asian students enrolled in Siberian universities remains much higher than in China. As a corollary, the Russian media (radio, TV) remain very present and influential in these countries. However, Kazakhstan will join Uzbekistan and Turkmenistan in replacing Cyrillic with the Latin alphabet for its vernacular language. In this respect, it should be noted that the local populations speak Turkish-speaking languages and are therefore close, at least culturally, to Turkey. The Tajiks are distinguished by their language, which is close to Persian. For Turkey and Iran, both language and Islam are significant vectors in their relations with the countries of the region.

**CHART 3
Governance**

Source: World Bank (2017)

DISCLAIMER

This document reflects the opinion of Coface's Economic Research Department at the time of writing and based on the information available. The information, analyses and opinions contained herein have been prepared on the basis of multiple sources considered reliable and serious; however, Coface does not guarantee the accuracy, completeness or reality of the data contained in this guide. The information, analyses and opinions are provided for information purposes only and are intended to supplement the information otherwise available to the reader. Coface publishes this guide in good faith and on the basis of commercially reasonable efforts as regards the accuracy, completeness, and reality of the data. Coface shall not be liable for any damage (direct or indirect) or loss of any kind suffered by the reader as a result of the reader's use of the information, analyses and opinions. The reader is therefore solely responsible for the decisions and consequences of the decisions he or she makes on the basis of this guide. This handbook and the analyses and opinions expressed herein are the exclusive property of Coface; the reader is authorised to consult or reproduce them for internal use only, provided that they are clearly marked with the name "Coface", that this paragraph is reproduced and that the data is not altered or modified. Any use, extraction, reproduction for public or commercial use is prohibited without Coface's prior consent. The reader is invited to refer to the legal notices on Coface's website: <https://www.coface.com/Home/General-informations/Legal-Notice>

COFACE SA
1, place Costes et Bellonte
92270 Bois-Colombes
France
www.coface.com

Russia has military bases, particularly in the fight against Islamist terrorism

Kazakhstan, Kyrgyzstan and Tajikistan are members of the Collective Security Treaty Organization (CSTO), which was established in 2002 under the auspices of Russia and host Russian military bases. In addition, Russia has the Baikonur space launch site in Kazakhstan until 2050 for an annual rent of more than USD 100 million. Nevertheless, no country in the region has recognised the annexation of Crimea or the secession of Abkhazia and South Ossetia, which shows the ambivalence of their feelings and illustrates their concern to spare all their partners. For its part, China seems to have a military base in Tajikistan located 12 kilometres from Afghanistan and probably intended to control the passage of radical Islamists and drugs¹⁴. This presence can be explained by the Quadrilateral Cooperation and Coordination Mechanism (QQCM) in Counter Terrorism, which has included China, Pakistan, Afghanistan and Tajikistan since 2016. In addition, Russia and China are members, alongside Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, India and Pakistan, of the Shanghai Cooperation Organization (2001), whose purpose is security, economic and cultural. The main regional concern of these organizations is the infiltration of the Taliban and the development of radical Islamism from Afghanistan, but also within the region itself (notably in Uzbekistan and Tajikistan), and their control. With the exception of Kazakhstan, radicalism finds fertile ground in poverty, the plight of Muslims in Xinjiang and the strong policies of Turkmenistan, Tajikistan and Uzbekistan on freedom. Finally, Russia presided over the establishment of the Caspian Treaty (2018). This legal framework should, at last, enable Turkmenistan and Kazakhstan to build a gas pipeline to export their gas more efficiently to Azerbaijan, Turkey and Europe. But, at the same time, it consolidates the domination of the Russian military presence by excluding non-riverside powers.

It therefore seems that the approximate distribution of roles, economic for China, security and culture for Russia, is maintained¹⁵. It is essential. The Chinese economy is eight times the size of Russia's. However, while Russia benefits from an old presence, China only burst in after the break-up of the USSR in 1991. In addition, regimes remain influenced by Russian governance practices. For the time being, the two powers find reasons for rapprochement in their opposition to the spread of radical Islamism, which involves stability in the region. However, this may change. Russia could take umbrage at the Chinese project of a European gauge railway through Kyrgyzstan, Uzbekistan and Turkmenistan (then Iran and Turkey), which would provide an advantageous alternative to passing through Russia¹⁶. Competition from the Caspian route could also be an issue. In addition, as Uzbekistan continues to open up, interest from Westerners and the Gulf countries is growing.

14 - Bogusz, M. & Mariusz, M. 2019. OSW : China's military presence in Tajikistan

15 - Stronski, P. & Ng, N. 2018. Carnegie: Cooperation and competition : Russia, China in Central Asia, the Russian Far East and the Arctic, Available at: https://carnegieendowment.org/files/CP_331_Stronski_Ng_Final1.pdf

16 - Goble, P. China's Plan for Railway to Uzbekistan Is Transforming Central Asian Geopolitics. *Eurasia Daily Monitor* Volume: 16 Issue: 40, 21 mars 2019