"China's Changing Role in Central Asia and Implications for US Policy: From Trading Partner to Collective Goods Provider"

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Prepared Remarks for "Looking West: China and Central Asia"
U.S.-China Economic and Security Review Commission
March 18, 2015

Members of the Commission, Ladies and Gentlemen:

Thank you for this opportunity to address you today as part of your hearing on China's growing role in Central Asia. It is an honor to participate along with leading experts on the topic. As others have underscored, we are examining this important issue at a critical time for the region and for US policy. For over a decade, US policy towards Central Asia has been an appendage of our security footprint in Afghanistan, focusing on securing access agreements and the logistics networks necessary to supply US forces. Although this was an important task, this singular focus prevented us from thinking more broadly and strategically about our longer-term interests in Central Asia and how China's growing economic engagement with the region might fit in with these reformulated objectives.

In general, let me offer qualified support for the position that China can help to forge a more interconnected Central Asia that will foster economic development and political stability. The region remains poorly governed and underdeveloped and China's efforts, including its new commitment to include the region as part of its new Silk Route initiative, should be generally welcomed. However, there are also some important caveats and policy challenges that China's emerging role in the region brings that I hope we can also discuss.

Scope of Economic Engagement: China's Emerging Role as Regional Patron and Collective Goods Provider

As has been repeated today China's increasing economic engagement with Central Asia has been nothing short of spectacular. In the year 2000, according to IMF trade statistics, China's overall trade with the Central Asian region was estimated at about $1bn (See Figure 1). By the end of the decade (2010), this figure had increased by thirty times and in 2013 trade volumes surpassed $50bn. During the financial crisis, China surpassed Russia as the region's leading trading partner, while the current economic tumult as a result of Russia's ruble crisis has further spotlighted China's crucial role as a regional economic stabilizer.

In addition to this exponential rise in trade, China has built critical new infrastructure, including two important new energy pipelines (the Atyrau-Alashankou oil pipeline across Kazakhstan and the China-Central Asia gas pipeline), new highways and rail networks, and emerged as the region's leading source of developmental finance. Considered as a whole, then, China's role in the region is shifting from external commercial partner to a more comprehensive regional provider of collective goods- including economic mediation and governance, development financing and even emergency lending. The political implications of these new economic roles remain unacknowledged in public, mostly out of sensitivity to Russia and Beijing's public deference to Moscow's position as the leading power in the region.

Pipelines and China's New Roles

Consider, for example, the broader implications of Beijing's considerable energy investments. The landmark China-Central Asia natural gas pipeline, inaugurated in December 2009, effectively broke the near monopoly that Russia's Gazprom exercised across the region. Since, the Russian energy giant has effectively ceded the region to China and CNPC. The China-Central Asia pipeline is comprised of three lines (A, B and C) that originate in Turkmenistan and traverse Uzbekistan and Kazakhstan before feeding into China's West-East pipeline network. By the end of 2015, this pipeline will deliver an estimated 55 billion cubic meters (bcm) of gas, or about 20% of China's annual gas consumption. In addition, a fourth line (line D) currently is being built that will transport gas in Tajikistan and also transit through Uzbekistan and Kyrgyzstan. This will add another 30 bcm in capacity and effectively expand the CNPC network into every Central Asian state.

Less appreciated is the political significance of the pipeline's legal structure. Unlike other pipelines that are consortia, the China-Central Asia pipeline is itself comprised of three separate join ventures, each based on 50% ownership between China and Turkmenistan, China and Uzbekistan and China and Kazakhstan. Effectively, this means that any regional disputes concerning price, volume, pipeline maintenance, or environmental impact will be mediated by the common party- China. Moreover, an additional spur of the pipeline in Kazakhstan has been built from Bozoy to Shimkent, which will link to the main export pipeline but will also deliver gas for consumption to Kazakh cities and industrial areas. In short, CNPC is becoming both a regional distributor and an exporter of Central Asian gas, as well as a *de facto* mediator among the Central Asian states in its network.

Loans for Energy Agreements

Second, China's particularly close relationship with Turkmenistan in energy development also carries an important patronage role. During the financial crisis, Beijing concluded two loans for energy deals with Turkmenistan, similar to deals it struck with Latin American energy producers, for about $8 billion. These loans effectively freed the cash-strapped government in Ashgabat from having to borrow money privately or from turning to international financial institutions. These emergency loans were secured with promises of gas deliveries and have yielded a mutual dependence: Turkmenistan remains China's single largest source of imported gas, while Turkmenistan is only second to Myanmar in terms of its dependence on China as an export market. China also concluded $13bn worth of loans-for energy deals with Kazakhstan, including most recently another $3 billion loan that was extended in 2013 after CNPC acquired a stake in the Kashagan international oil consortium. China's energy deals and financial power have made it a regional lender as well as a leading investor in Central Asia's energy producers.

China as a Development Assistance Provider

Third, China, through government-sponsored agencies such as the Export-Import Bank, has expanded its role as a development assistance provider by funding a number of regional infrastructure projects. The announcement in 2013 of the New Silk Route Belt was accompanied by a series of high profile visits by President Xi Jinping to each Central Asian country where he announced new multi–billion dollar investment packages and the upgrading of these bilateral relations to strategic partnerships. China already has been financing the construction of highways, railway networks and energy infrastructure. According to the World Bank, the Chinese Export-Import Bank remains, by far the largest single creditor to aid-dependent Tajikistan, as of July 2014 held 41.3% of Tajikistan's external debt, compared with the World Bank and Asian Development Bank that held 16.4% and 14.3%, respectively. Chinese specialists and academics last year also communicated to me that they would like to also offer technical assistance on developmental issues, comparable to what USAID or the European Union provide to the region.

Whose Backyard? Russia's Reaction

China's emerging role of 'collective goods" provider has been accepted, but not embraced by other regional parties. Russia, in particular, supports Chinese economic activities and Russian officials and analysts posit a distinct division of labor that both sides are confortable with: China provides economic investment, while Russia provides security and exerts political influence. Yet, this distinction does not always line up so tidily. Most notably, Russia has quietly opposed or dragged its feet on nearly every major economic initiative that China has proposed within the framework of the Shanghai Cooperation Organization (SCO)- the regional organization, established in 2001, comprised of China, Russia, Kazakhstan, Kyrgyzstan Tajikistan and Uzbekistan. For example, Moscow opposed early Chinese calls to make the SCO a vehicle for a regional trade agreement, while during the financial crisis it refused to contribute to a $10bn emergency SCO anti-crisis fund that Beijing had proposed to provide infrastructure investment to the region. Then, in the run-up to the 2012 SCO summit in Beijing, Russia tabled a Chinese-backed initiative to create an SCO Regional Development Bank.

Russia is reluctant to further empower China, even in a multilateral setting, as it prefers instead to promote its own regional economic architectures such as the Eurasian Economic Union (comprised of Russia, Belarus, Kazakhstan, Armenia, and Kyrgyzstan as of May 2015), or the Russian-Kazakh Eurasian Development Bank. Beijing in private has grown frustrated with this Russian reticence, but, undeterred, China has continued its economic activities bilaterally, often referring to its own initiatives as "SCO" projects.

The New Silk Road: Regional and US Policy Challenges

How, then, should the United States respond to China's growing regional footprint and its shift to a role as a regional patron, mediator and collective goods provider? Central Asia remains a region that is investment-starved and in desperate need for upgrades in its crumbling, Soviet-era infrastructure. The upgrades that China is providing are vital, even if they are tied to a broader Chinese strategic agenda of connecting much of the Central Asian region with Xinjiang in an attempt to modernize and stabilize its restive Western region. However, I do wish to flag some caveats for the Commission that I also believe are important to consider.

The Developmental Challenge: Hardware vs. Software

First, while a general upgrade of the region's infrastructure is urgently needed, an influx of large amounts of external funds for the completion of large projects will strain the region's absorption capacity.

We can think of the issue as developmental hardware versus software. The current assumption of Chinese leaders is that better "hardware," in the form of modern infrastructure, will spur economic development and improve market-oriented practices. But the region is challenged as much by its poor "software"- particularly corruption and rent-seeking– at all levels of government. We should not underestimate the extent of these governance challenges, for Central Asia today remains one of the trade-unfriendly regions in the world. Bureaucracy and red tape continue to hamper formal economic exchange, while state agencies and border officials continue to profit from regulations associated with cross-border transactions.

As Figure 2 shows, in 2014 the average time for imports and exports in Central Asia, based on World Bank "Ease of Doing Business" data, was 79/67 days, having improved modestly from 85/79 days in 2006. However, these long import/export times are still three times longer than comparable times from Eastern Europe and Latin America and the Caribbean, nearly three times longer than the Middle East, and still over twice as long as comparable indicators from South Asia. Simply put, I see little evidence that the trade climate has significantly improved in the region over the last decade, despite the numerous externally-sponsored trade and investment projects that outside actors, including the United States, have introduced.

Accordingly, we will have to see whether large injections of Chinese funding for public works will actually support the strengthening of market institutions and norms in the region or, instead, whether expectations of more large-scale projects will lead national and local elites to anticipate more opportunities for government predation. Finally, even if these projects deliver the infrastructure improvements that they promise, the twin issues of capital flight and kleptocracy continue to plague the region. According to the IMF, for example, Tajikistan suffered capital flight of about 60-65% of its GDP in recent years. Thus, an additional concern with the New Silk Route that I have is that these funds may ultimately make their way to offshore bank accounts and opaque companies, rather than into the region that they are supposed to be economically integrating. The New Silk Route Economic Belt may take several detours off course.

Displacing US-Led Governance Standards and Institutions

A second concern for US policymakers should be the question of whether this new Chinese role as a regional collective goods provider is weakening the influence of international lenders in the region and eroding international governance standards, most notably in the areas of controlling corruption and protecting the environment.

A striking feature of Chinese lending and financing in Central Asia is how walled off it remains from the activities of other international donors in the region. Unlike other aid-intensive areas, Chinese officials in Kyrgyzstan and Tajikistan, the region's two most aid–dependent states, do not coordinate or plan their activities with other donors. Perhaps this itself is rooted in the fact that China's policy towards Central Asia is framed by its regional concerns about Xinjiang, but for international officials active in the region this remains a source of frustration and uncertainty regarding the terms and purpose of Chinese projects.

As this committee is undoubtedly aware, US policy towards new Chinese-led regional lending institutions has varied. In recent years US officials have broadly supported the SCO's efforts in Central Asia, showed some caution about the new Development Bank of the BRICS, and most recently, have been openly critical of the Asian Infrastructure Investment Bank (AIIB). US concerns about the AIIB's lax standards for governance, accounting and lending criteria are especially applicable to the Central Asian cases. Though the exact scope and activities of the AIIB are still being discussed, it is likely that the bank's operations will extend into Central Asia; Kazakhstan and Uzbekistan, the region's two biggest economies, were among the 21 original founding members, (along with Pakistan), while Tajikistan joined the AIIB in January 2015.

These concerns merit careful consideration and are supported by actual recent episodes in the region. According to the International Crisis Group, for example, Chinese funding of Tajikistan's cross-country Dushanbe-Chanak highway provides a cautionary tale about how China's unconditioned loans can be used by local officials for their own narrow purposes. Soon after the completion of the highway in 2010, tollbooths appeared on the road and an opaque company registered in the BVI started collecting revenues. The toll effectively made the road prohibitively expensive for many Tajiks. What had been intended by China as a project to benefit the country as a whole, had generated what appears to be a private income opportunity.

This anecdote also touches on a final, related concern: that governments in the region may use the presence of Chinese patronage, regardless of Beijing's actual intentions, to push back and bargain against the conditions and terms demanded of them by more traditional Western lenders. US policymakers should be aware that this "alternative patron" problem will continue to diminish the power of conditional lenders, even when dealing with weaker and more economic dependent countries that now have other options for their development and project financing.

Reconciling US Policy towards Eurasia and East Asia

Finally, from a strategic perspective, US officials also need to engage in long-term planning about how to connect what are currently distinct regional policies towards Eurasia and East Asia. In Eurasia and Central Asia, US officials tend to view Chinese economic activity as decreasing these states' dependence on Russia and as therefore increasing their sovereignty and independence, while in East Asia, a more competitive view of China's regional role has emerged as embodied in the discussions about the rebalance and negotiations over the Trans-Pacific Partnership (TPP). Certainly, in the area of US policy towards the SCO, Chinese officials have expressed confusion at how the various divisions in the State Department (South and Central Asia, Russia and Eurasia, East Asia, International Organization Affairs) each developed a different view regarding the SCO's purpose and US policy towards it.

For their part, Russian policymakers and analysts increasingly assert that Russia's pivot towards Asia and China will become an important geoeconomic source of influence and a new potential axis to balance against the West. Ultimately, this is an uncomfortable formulation for Beijing, which does not want to be forced into choosing between economic engagement with Russia and its economic engagement with the West. Contrary, to some alarmist views, the West has little to fear from increasing Russia-China-Central Asian economic cooperation and integration, especially if it helps to embed Central Asia into new trade networks and transit corridors that will increase overall Europe-Asia commercial ties. Russia will have to prove itself a reliable partner in these new links, otherwise these new networks will not be used to their potential.

A more pressing strategic issue for US policymakers is to fashion a response if Beijing starts to link US policy in one region to the other. For example, how would Washington react if Beijing conditioned more cooperation and economic assistance to Afghanistan to the US backing off from some of its recently announced commitments to its Pacific allies that were made as part of the rebalance? Ultimately, US officials need a more consistent and principled policy towards China's growing role as a collective goods provider that can be applied across the many regions, including Central Asia, where China continues to make important inroads as an economic patron.

Thank you ladies and gentlemen and I look forward to answering your questions.

Figure 1:

Central Asian trade with China and Russia, 2001-2013

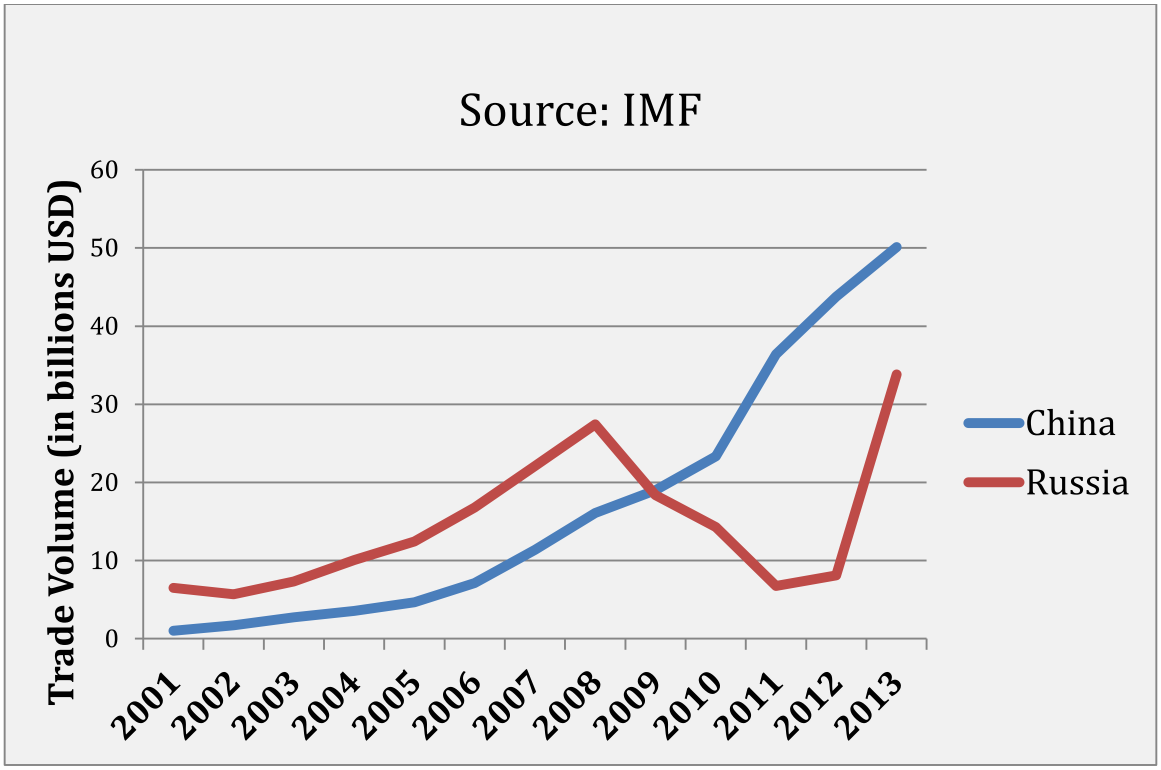

Figure 2:

Central Asia's Informal Trade Barriers and Border Controls in Comparative Perspective