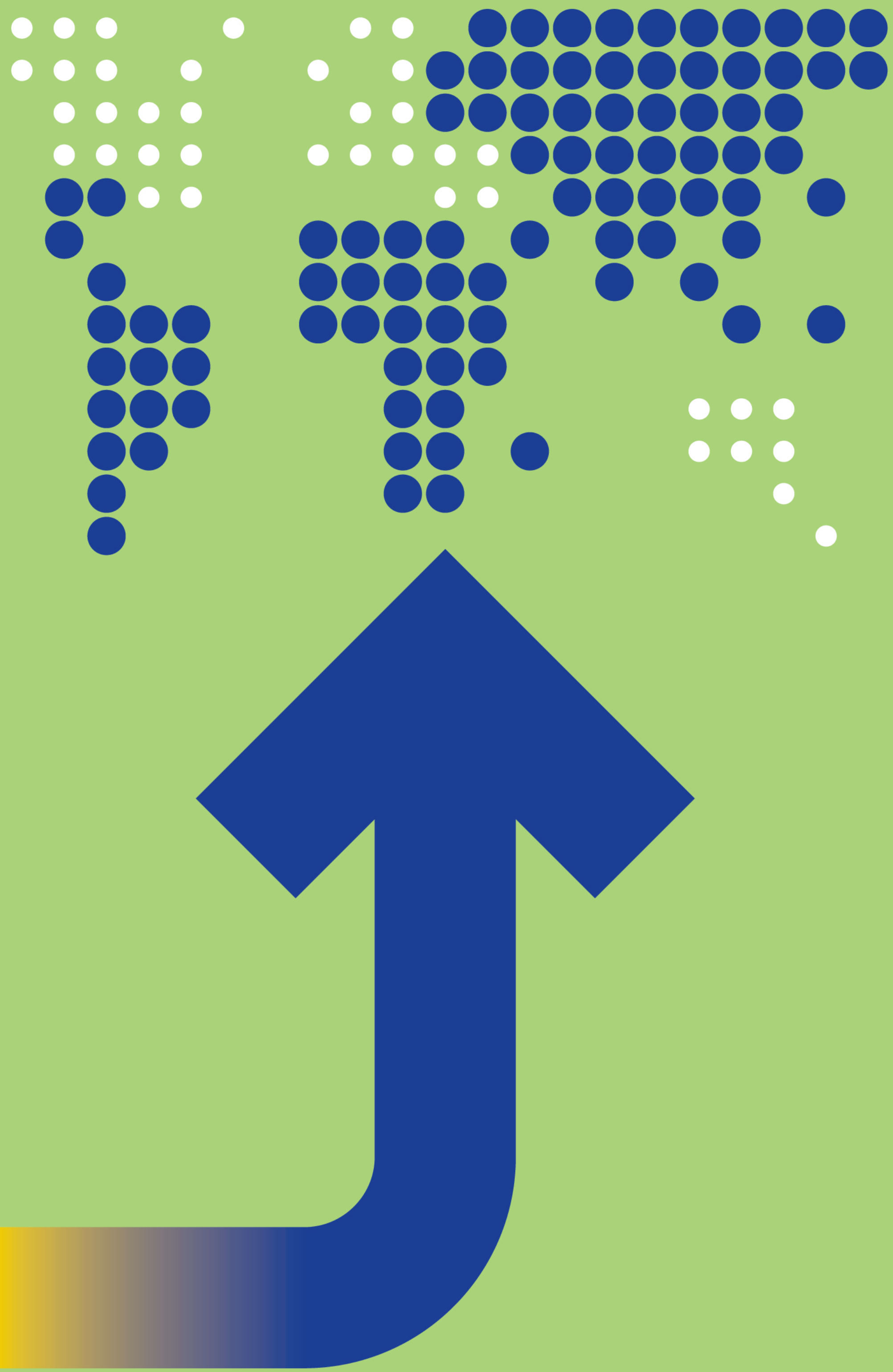
EMERGING MARKETS FORUM



Maximizing the Positive Impacts and Minimizing the Risks of the BRI in the Central Asia and South Caucasus Region: A Policy Paper

Emerging Markets Forum
A nonprofit initiative of the Centennial Group

Executive Summary

This policy paper is based on a comprehensive study carried out by the Eurasia Emerging Markets Forum (EMF), with support from the Swiss National Bank (SNB). The core of this study was an "inside-out" analysis of the economic and social impacts of the Belt and Road Initiative on countries in the Central Asia and South Caucasus (CASC) region from the perspective of these countries. These regional country perspectives were supplemented by the perspectives of key outside stakeholders and benefited from feedback from the IMF, World Bank and other IFIs. The 12 draft papers presenting these perspectives were debated in a two-day Forum in Switzerland to assess their validity and policy proposals.

Key findings: There are three key findings of this study. First, there is a good fit between the objectives of the BRI and the needs of the region in principle. This Chinese landmark initiative potentially offers significant opportunities to individual countries and the region as a whole. Second, these opportunities are associated with important uncertainties and risks that need to be identified and must be managed. And third, the study identified a package of policy actions that will allow the region as a whole to maximize the benefits of the BRI while minimizing its risks.

Major potential benefits: Seven of the eight countries in the CASC region are landlocked. They are also poorly connected with each other and with the rest of the world. According to the World Bank's Multidimensional Connectivity Index, the CASC countries rank in, or are close to, the bottom quintile globally. Intraregional trade in CASC is also among the lowest in the world. Clearly, connectivity is critical for the region's future growth and prosperity and for its greater economic integration with large markets in Asia and Europe. The BRI is likely to support increased connectivity for CASC. The resulting reductions in transportation costs would in turn spark other significant benefits, including higher economic growth through enhanced competitiveness; greater investment and trade flows; higher fiscal revenues; enhanced productive capacity in industry and agriculture; increased tourism; technology transfer; and improved human capital and employment. Overall, if well designed and managed, the BRI can yield large payoffs to the CASC region.

Key risks: As with any ambitious development program, the BRI also involves significant challenges and risks for the region's economies. While many of these risks are common to most countries, they are greater in the smaller countries and in those with weaker governance.

The most important challenges and risks associated with the BRI arise fundamentally from (i) BRI investments' effect on host countries' fiscal and debt situation, (ii) whether BRI projects yield adequate economic and financial returns to host countries (as distinct from profits to foreign—Chinese—promoters and investors), (iii) whether these investments (and associated projects) are planned and designed to fit with national needs and priorities, (iv) how BRI projects are financially structured, and (v) how rigorously they are evaluated before approval and subsequently monitored during implementation. Specifically, there are important risks of higher fiscal vulnerabilities and unsustainable debt accumulation, which could cause macroeconomic instability. These risks would be especially pronounced if investments are unproductive. In this context, it is also important to take into account the fact that operations and maintenance (O&M) requirements could lead to substantial ongoing costs. Potential damage to the environment, lack of attention to operations and maintenance, use of outdated technology, lack of transparency and competition in the award of contracts, and inadequate job creation were identified as other potentially serious problems in a number of countries.

Policy recommendations: The most important actions needed at the national and regional levels and by China and members of the global community are summarized below; individual policy actions are mutually reinforcing and, therefore, should be considered together as a package.

National level

1. *Integrate the BRI into national plans:* The single most important factor in determining the success of the BRI in promoting the overall economic development of the countries is the degree to which BRI investments are effectively integrated with their national plans and priorities.
2. *Conduct rigorous cost-benefit analysis:* Project approval processes must involve careful appraisal of each project's economic, financial, environmental and social viability, with special attention paid to each major project's impact on the fiscal and debt sustainability of the country.
3. *Focus on developing secondary and tertiary infrastructure:* Upgrade subnational physical connectivity in order to create opportunities for local businesses to take advantage of trunk infrastructure constructed under the BRI.
4. *Accelerate soft infrastructure reforms:* Implement policy and institutional reforms to improve "soft infrastructure" so as to fully benefit from BRI investments in connectivity.
5. *Prioritize operations and maintenance and allocate necessary resources:* Pay particular attention to the significant long-term operations and maintenance (O&M) needs of the entities responsible for running BRI facilities; non-prioritization of O&M has led to decay in existing infrastructure and can sharply curtain the useful life of expensive new assets.
6. *Promote greater transparency:* Ensure more openness, transparency and information sharing about BRI investments; they are critical for the initiative's credibility within BRI countries and for ensuring above board project selection.
7. *Ensure competitive procurement and construction contracting:* Agree with China on transparent and competitive procurement processes that would ensure efficiency, create equal opportunities for local businesses and minimize corruption.
8. *Build independent domestic institutions to formulate and implement policies on the above-mentioned issues:* This will ensure integration of the BRI with each country's needs and priorities.

Regional level

9. *Accelerate regional cooperation and integration:* Build on recent efforts to enhance regional cooperation and integration to increase regional trade and investment flows; regional cooperation is a must for the region to reap the full benefits of the BRI.
10. *Leverage the support of IFIs and other partners:* Actively seek support from other development partners (including the IFIs) in complementing BRI investments in the region to ensure effective economic integration of the CASC countries with each other and with Eurasian and global markets.
11. *Create a high-level regional platform:* Consider developing a high-level regional platform to discuss strategic BRI-related regional issues and to ensure a fruitful partnership between China and the CASC region.

China and the global community

12. *(China) Open the BRI to multilateral cooperation:* China should follow through on its intention, stated at the Second Belt and Road Forum in April 2019, to open the BRI to multilateral cooperation, and IFIs should accept China's invitation to collaborate toward this end. This transformation of the BRI would make it much more transparent and facilitate international engagement, which in turn would address many of the issues and risks outlined above.
13. *(IFIs) Work with China to multilateralize the BRI:* The IFIs should collaborate closely with China and the countries to help them make the BRI a multilateral initiative, as the Chinese authorities have invited them to do.
14. *(IFIs) Assist the countries in assessing the impact of the BRI on their economies:* When requested, the IFIs should use their expertise to help countries in the region to analyze the costs and benefits of BRI projects on their economies.

Many of the key takeaways (benefits, risks and policy recommendations) are likely to be relevant and apply to most other BRI countries. In that sense, even though this policy paper is focused on the CASC region, it can and should be seen as a "case study" for other regions involved in the BRI.

Maximizing the Positive Impacts and Minimizing the Risks of the BRI in the Central Asia and South Caucasus Region: A Policy Paper

Emerging Markets Forum

Introduction

Since its launch in 2013, the BRI has become the most talked-about south-south development cooperation initiative. There are almost daily press stories about it, and numerous summits and meetings around the world have been convened to discuss it. Yet, much of the current discourse is limited to the geopolitics of the BRI. Despite its massive size, fast-expanding geographic footprint and high visibility, many key economic and social aspects of the BRI remain unclear. Without more factual information about these key aspects, it is difficult for policymakers to decide how to maximize its potential benefits and minimize its risks.

To fill the above gap, during the past year the EMF, with support from the SNB, has carried out a comprehensive study of the economic and social impact of the BRI on a region that is expected play an important role in the context of the BRI: the CASC region[1]. A team of 21 experts, based in 11 countries, carried out this study.

The study has four distinguishing features. First, it reviews the evolution of the BRI globally since its inception over five years ago to put its presence in the CASC region in a broader context. Second, it takes a deeper “inside-out” look at the BRI from the perspective of the eight CASC countries, in contrast to the typical top-down or “outside-in” analyses by outsiders. Third, the study supplements these inside-out perspectives with the perspectives of five outside players that have a major interest in the CASC region (China, Russia, India, the EU, and the USA). In addition, it takes into account the views of major international institutions, such as the International Monetary Fund (IMF), the World Bank (WB), and the Asian Development Bank (ADB). Finally, the study derives practical policy implications for top decision makers in the concerned countries, international financial institutions and China.

This work was discussed and debated at a meeting of the Eurasia Emerging Markets Forum held in Gerzensee, Switzerland during January 27-29, 2019. Some 60 participants from within the CASC region, IMF, WB, ADB, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), Japan International Cooperation Agency (JICA) and Switzerland (SNB, State Secretariat for Economic Affairs [SECO], and State Secretariat for International Finance [SIF]) attended the Forum. This paper thus reflects both the unique blend of the various perspectives represented and the consensus reached at the Forum. The participants considered the findings of the study especially timely in light of the fact that significant flows of BRI investments in the region could be expected in the next few years. Moreover, they felt that the CASC countries should take proactive steps soon to maximize the BRI’s benefits and minimize its downsides.

This policy paper is written primarily for the consideration of top decision makers in the CASC countries. Its objective is to present a balanced view of the BRI. It does so by outlining both the most important benefits and opportunities, as well as the most pressing challenges and risks, for the countries.

The paper is structured as follows. Section 1 below briefly describes the overall design and history of the BRI, and its expansion since its launch in 2013; it also provides a rough estimate of Chinese investments in BRI countries. Section 2 outlines the BRI’s major potential benefits and the key risks that the CASC countries face, as highlighted by the “inside-out” analysis, complemented by the other perspectives brought together by the Forum. Thereafter, the heart of the paper follows in Section 3. It discusses the main policy issues that the CASC countries need to consider in order to maximize the positive impact of the BRI and manage its downside risks. The paper ends with the concluding section, which summarizes the key takeaways.

1. The region includes the following countries: Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan in Central Asia; and Armenia, Azerbaijan, and Georgia in the South Caucasus.

1. Structure and history of the BRI

Since its inception in 2013, the BRI has more than doubled its geographic coverage and mobilized hundreds of billions of dollars in debt and equity finance. But despite its centrality to BRI corridor plans and numerous investment opportunities, the CASC region has absorbed a modest share of BRI investment worldwide.

1.1. Background of the BRI

The BRI has the potential to be one of the most transformative development programs since the creation of the Bretton Woods Institutions in the aftermath of the Second World War. If the BRI is indeed implemented at the scale currently anticipated, its size could turn out to be at least seven times that of the Marshall Plan in real terms[2]. The scale and geographic reach of the BRI are all the more impressive considering that the initiative was conceived and is being financed mainly by a country that is still classified as a developing economy. It is also the most ambitious example of south-south cooperation in history and can make a significant contribution to the global community.

Under the terminology of the BRI, the "Belt" refers to surface connectivity (through the Silk Road Economic Belt) and the "Road" to maritime routes (through the Maritime Silk Road)[3]. The Silk Road Economic Belt in turn consists of six economic corridors: one in Southeast Asia, two in South Asia, two in Central Asia and Europe, and one in North Asia. These six corridors, along with the Maritime Silk Road, comprise the BRI's seven original corridors. More recently, a "Polar Road" and a "Cyber Route" have been added to the seven original corridors.

2. Jonathan Hillman (2018), "China's Belt and Road Is Full Of Holes," CSIS.
3. National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce of the People's Republic of China (2015), Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road.

1.2. Status of the BRI six years of after its launch

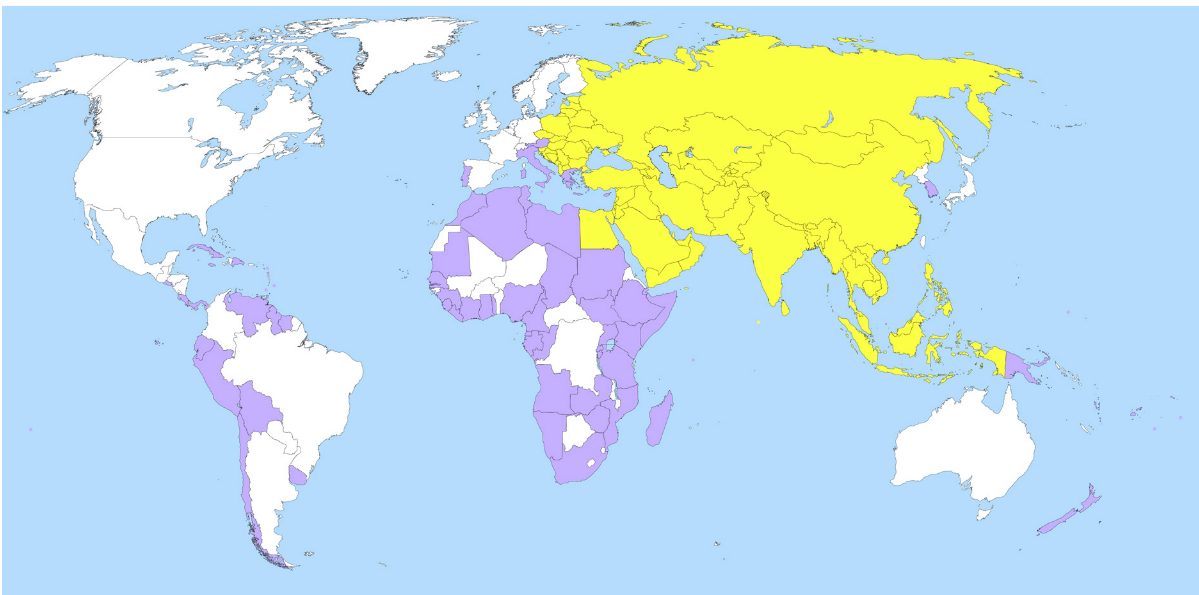
The official list of BRI countries has grown from 65[4] in 2013 to 132 as of May 2019 through the addition of 67 more countries, mainly in Africa, Latin America and Europe[5]. Thus, the BRI's reach has extended far beyond the ancient silk routes.

After a stable membership of about 65 between the BRI's inception in 2013 and 2016, there has been a dramatic increase in the number of countries deemed by the Chinese authorities to be part of the BRI. This increase is demonstrated by the signature of a very large number of bilateral MOUs on Belt and Road cooperation between China and partner countries since 2018.

The 132 countries that comprise the Belt and Road Initiative as of May 2019 account collectively for 35 percent of global GDP, 43 percent of the global merchandise trade, and 60 percent of the world's population[6].

4. China's official list of BRI countries continued to include India until last year despite India's reservations toward the initiative on political and economic grounds.
5. These figures are derived from research conducted jointly by EMF and the Emerging Markets Institute, EMF's sister institution at Beijing Normal University.
6. EMF estimates. These figures do not include Austria or Italy, whose MOUs with China on building the Belt and Road focus on third-country cooperation.

Figure 1: BRI countries in 2013 (yellow) and additions by May 2019 (purple).



Source: Emerging Markets Forum

It is noteworthy that the initiative picked up significant momentum during 2018, despite mounting criticism of the BRI in some media. Also, as highlighted in Figure 1, while the original BRI countries were mainly in Asia and the Middle East, the vast majority of the latest additions are in Africa, Latin America, and Europe.

18 member states of the EU, including five of the core EU-15, have already signed BRI MOUs. With Italy signing onto the BRI in March 2019, it has become the first G-7 country to do so. The bottom line is that the BRI has already developed an almost global footprint, a substantial change from its Eurasian beginnings just five years ago.

Preliminary estimates and direction of Chinese investments under the BRI

The size of ongoing and anticipated investments under the BRI appears to be massive. Yet, despite its high profile and by now almost six-year-long existence, there is no precise public information about Chinese investments under it. There is also no single outside authoritative source that collects and reports that information. To fill this important information gap, the EMF has attempted to develop preliminary estimates of Chinese investments (equity and debt) in BRI countries (during 2013-18) by collating and cross-checking data from various Chinese and non-Chinese sources.

Based on a review of all this disparate data, it is possible to draw the following tentative conclusions:

1. Total Chinese financial exposure to BRI countries is very significant and was rising through end-2018.
2. Chinese outward FDI disbursements amounted to US$96.3 billion between 2013-18.
3. The Silk Road Fund had committed US$11 billion along the Belt and Road as of end-2018.
4. Total cumulative loan commitments and disbursements of all Chinese banks (policy banks as well as three of the four state-owned commercial banks) to BRI countries were about US$580-600 billion, of which:
   a. The China Development Bank's cumulative disbursements were US$190 billion as of December 2018;
   b. The Export-Import Bank of China's net disbursements were US$149 billion as of February 2019; and
   c. Three other major state-owned Chinese commercial banks' combined disbursements and commitments totaled US$245 billion through December 2018.
5. For reference, the four legacy multilateral development banks (the WB, ADB, African Development Bank and Inter-American Development Bank) altogether lent about US$490 billion between 2013-17 throughout the world.
6. While the FDI and loan disbursement data are robust, the data on loan commitments is soft in that a breakdown by country or project is impossible.
7. About 20 percent (US$13.4 billion) of China's official lending to BRI countries during 2013-14 qualified as official development assistance[7].
8. Despite the informal name of the initiative—the New Silk Road—only a small portion of China's total investments have so far been directed to BRI countries in the CASC region. The bulk of investments in the BRI countries have been in Southeast Asia, South Asia and Russia.
9. Energy (both extraction and generation) projects have been the major beneficiaries of both equity and debt investments. The real estate sectors of relatively high-income countries (Singapore, South Korea and Malaysia) have also received a significant amount of equity investment.

1.3. The BRI and the CASC region

In principle, there is a good fit between the objectives of the BRI and the needs of the CASC region.

A major objective of the BRI is to connect the two largest economic regions of the world—China (and the rest of East Asia) and Europe—in order to maintain and increase trade flows between them. The BRI also aims to facilitate development of other emerging economies, particularly China's neighbors, through improving connectivity and enhancing trade and investment flows[8].

The CASC region is geographically close to China and also situated at the core of the Eurasian continental space, thus making it strategically crucial for China's desire to build land-links with Europe, whether by rail or road.

Two of the six overland BRI corridors identified in official communications by Chinese authorities run through the CASC region. These are the "New Eurasian Landbridge" and the "China-Central Asia-West Asia Economic Corridor." The New Eurasian Landbridge involves only Kazakhstan

7. To qualify as official development assistance, a loan must be "administered with the promotion of the economic development and welfare of developing countries as the main objective" and have a grant element of at least 25 percent. See Austin Strange, Mengfan Cheng, Brooke Russell, Siddhartha Ghose, and Bradley Parks (2017), "Tracking Underreported Financial Flows (TUFF) Methodology, Version 1.3," AidData.
8. Harinder S. Kohli and Leo M. Zucker (2019), "An Economic Perspective on the Belt and BRI: Five Years after its Launch," Emerging Markets Forum.

from among the countries of CASC, while the China-Central Asia-West Asia Economic Corridor involves potentially all of the region's countries.

Separated by the Caspian Sea into two sub-regions and surrounded by large neighbors, including Russia, China, Iran, Turkey and—across the Black Sea—the European Union, all CASC countries are landlocked (except for Georgia). They are also poorly connected with the rest of the world (and even with each other). This is reflected in the World Bank's Multidimensional Connectivity Index, which ranks 112 countries according to their links with the rest of the world in terms of trade, FDI, migration, ICT, airlines and portfolio investment. The CASC countries rank in, or close to, the bottom quintile. Their intraregional trade is also among the lowest in the world.

While the CASC region covers a large land area, its population is only 86.5 million people. It is also highly diverse in population and income levels, ranging from the largest country, Uzbekistan (with 31.8 million people), to the smallest one, Armenia (with 2.9 million people) and from per capita incomes as high as US$8,760 in Kazakhstan to only US$800 in Tajikistan (as of 2017, in current US dollar terms). Some are commodity exporters (mostly oil and gas), while others are net commodity importers.

Given the above, it is obvious that the region has much to gain from the BRI's emphasis on connectivity, industry, agriculture, trade and investment flows, provided that BRI investments fit well with the countries' needs and priorities and that investments are well selected and executed.

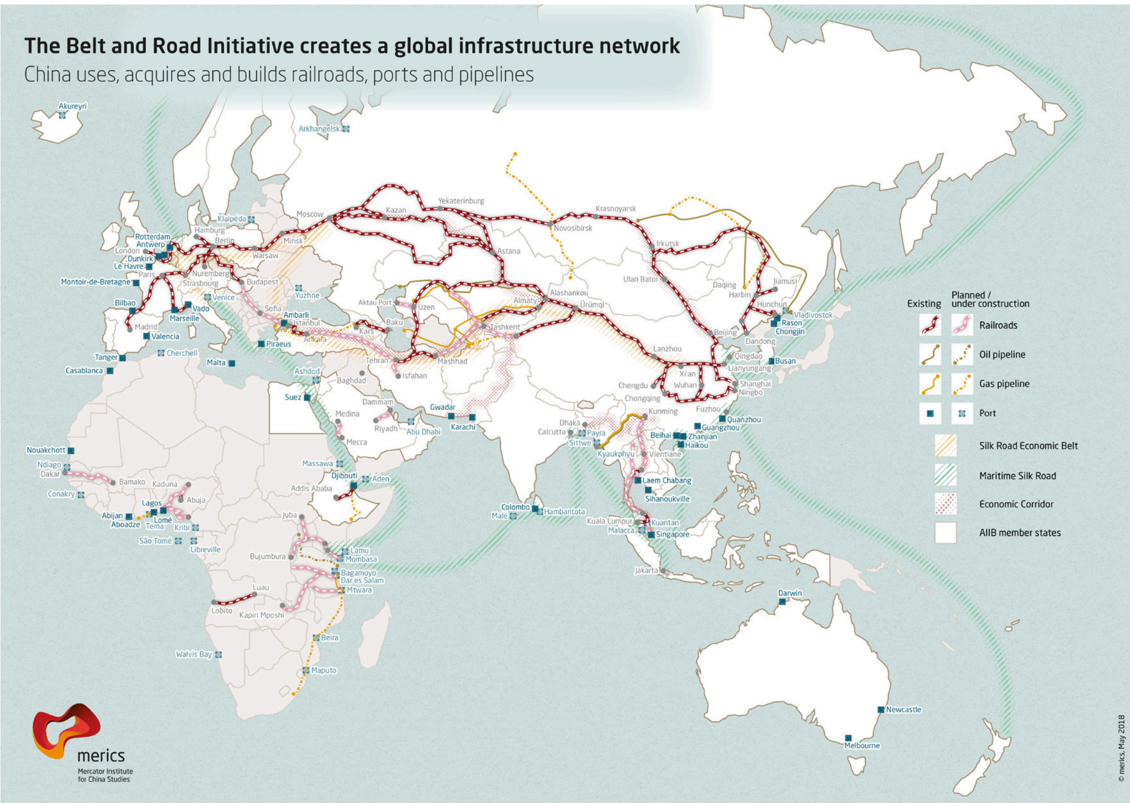
BRI investments in the region so far

China has made significant investments in the CASC region in recent years, with many projects already having come online and others under implementation.

The most prominent projects that are already in operation include the two transcontinental east-west rail corridors connecting China to Western Europe, as well as a number of oil and gas pipelines that have started exporting hydrocarbons from Kazakhstan, Russia and Turkmenistan to China. In addition, Chinese companies have developed mineral (including coal and gold) and power projects in some countries in the region. There have also been investments in transport and agriculture, as well as in industrial estates, but not on the scale matching those in the energy and mineral sectors.

By volume, most BRI investments in the CASC region have gone to Kazakhstan. But in relative terms, Chinese investments have had an outsized economic and social impact in the Kyrgyz Republic and Tajikistan,

Figure 2: Map of BRI corridors



Source: Mercator Institute for China Studies given these countries' small size. In comparison, very few Chinese investments have thus far gone into the three Caucasus countries.

Overall, so far the CASC region has absorbed a very modest share of total BRI investment worldwide. Given China's keen interest in its immediate neighborhood and the potential investment opportunities in the CASC region, there is scope for a significant increase in Chinese investments there in the next few years. It is therefore very timely for the CASC countries to proactively take policy actions to make sure that future BRI investments are put to the best possible use from the host countries' perspective.

Based on the "inside-out" reviews of countries' experiences with BRI investments so far, the following lessons can be drawn on the BRI's potential opportunities, challenges and risks for the CASC region.

2. Major potential benefits and risks of BRI for the region

As is the case with any major development initiative, the BRI offers major potential benefits and opportunities to the CASC region, but also presents significant challenges and risks. These are summarized below.

2.1. Major potential benefits

The major potential benefits for the CASC region arising from the BRI can be summarized as follows.

1. *Lower transportation costs through increased connectivity:* The basic building block of these opportunities is also the central component of the BRI: connectivity in the form of a network of railways, highways, oil and gas pipelines, and, more recently, a cyber route crisscrossing the region and connecting China with Europe and parts of the Middle East. Most of these connections are east-west-oriented and aimed at facilitating trade between China, Europe, the CASC region and Russia. These physical connectivity projects have the potential to dramatically reduce transportation times and costs within the region.
2. *Increased competitiveness, contributing to higher trade and investment flows:* The resulting improved connectivity with the two largest economic and trading regions of the world (Asia and Europe) and the drop in transportation costs has the potential to enhance the CASC countries' competitiveness, thus enhancing prospects of future investment and trade flows to the region.
3. *Accelerated growth of the natural resource, manufacturing, agriculture and tourism sectors:* Until now, most BRI investments in the region have focused on extracting and exporting natural resources (oil, gas and other minerals) back to China. In addition, private Chinese entrepreneurs have started investing in small enterprises involved in manufacturing, retail and tourism activities. More importantly, over the medium to long term, the BRI's much larger benefit for the region may be its emphasis on industry and agriculture as well as trade and financial (investment) flows. To realize this promise, the countries need to improve the domestic business environment while also taking steps to enlarge the size of "local markets" by creating more CASC region-wide markets for most products.
4. *Enhanced fiscal revenues, royalties and transit fees:* Well-designed and financially sound BRI projects should yield significant additional fiscal revenues through royalties, transit fees and taxes.
5. *Greater inflows of Chinese capital:* The BRI is associated with large flows of Chinese capital (both equity and debt). China has been willing to provide capital in amounts not usually available from traditional official or private sources. While for the larger countries (Kazakhstan and Uzbekistan) the relative size of Chinese investments compared to their total national investments may be modest, for the smaller economies the amounts are significant both in absolute and relative terms. If channeled to economically viable projects that fit well with national priorities, these Chinese capital inflows could provide a welcome boost to the countries.
6. *Increased technology transfer:* China has an important record of building modern infrastructure and developing industrial and IT capacity quickly and reportedly at very competitive prices. It is thus capable of transferring modern technology to CASC countries at competitive rates. But BRI host countries must take the initiative in ensuring that these transfers do occur in practice. Otherwise, they face the risk of Chinese contractors interested in short-term profits saddling the projects with outdated technology in order to save money and time (such as in obsolete coal-based power plants).
7. *More human capital development:* China has the capacity to provide technical assistance, training and educational facilities to develop human capital under the fifth thematic area of the BRI:

people-to-people exchanges. Depending on their specific needs, countries in the region should proactively develop strategies on how to take advantage of this opportunity.

8. *Higher long-term economic growth and living standards:* The cumulative result of all these positive developments would be higher economic growth rates for the countries and the region. A critical precondition for sustaining such improved growth would be better national economic policies, business environment and institutional frameworks, as well as much greater regional cooperation.

2.2. Key risks

The most important challenges and risks associated with the BRI arise fundamentally from (i) BRI investments' effect on host countries' fiscal and debt situation, (ii) whether BRI projects yield adequate economic and financial returns to host countries (as distinct from profits to foreign—Chinese—promoters and investors), (iii) whether these investments (and associated projects) are planned and designed to fit with national needs and priorities, (iv) how BRI projects are financially structured, and (v) how rigorously they are evaluated before approval and subsequently monitored during implementation.

The key risks for the CASC region arising from the BRI can be summarized as follows.

1. *Higher fiscal vulnerabilities and unsustainable debt accumulation, which could cause macroeconomic instability.* These risks would be especially pronounced if investments are unproductive and if fiscal vulnerabilities are already high.
2. In *infrastructure, trade and investments flows*, improvements in "soft infrastructure" (e.g. resolving behind-the-border policy and institutional constraints) and the business climate within countries and across the region are absolutely essential. If insufficient attention is paid to improvements in soft infrastructure, neither the full benefits from BRI transport projects will materialize, nor will the expected level of trade and investment flows come through.
3. In *natural resource projects*, risks relate to potentially unfair benefit sharing between producers/exporters (host countries) and investors/importers (China), insufficient transparency regarding public revenues generated by projects and their utilization, and lack of attention to environmental and climate impacts (especially in case of mining projects).
4. *Inadvertent environmental degradation* caused by some BRI projects (e.g. coal-fired power projects, ill-designed mining projects, major infrastructure projects).
5. Possibly excessive competition between major transport corridors and a potential lack of demand, excessive and/or imbalanced investments, insufficient attention to soft infrastructure.
6. Underestimation of potentially significant long-term *operations and maintenance* (O&M) costs of new infrastructure assets represents a serious potential risk to the sustainability of benefits anticipated from BRI investments.
7. In some instances, BRI projects so far have contributed little to domestic *job creation* due to excessive use of imported Chinese labor. This Chinese immigration (especially in countries neighboring China) and Chinese land acquisition raises the probability of popular unrest.
8. Another risk is the potential *loss of domestic productive capacity* as connectivity improves and foreign competition becomes more of a threat to domestic producers no longer protected by high transport costs and trade barriers.
9. There are multiple concerns about the *governance aspects of the BRI*, including issues of transparency (and the potentially corrosive impact of the current secrecy associated with BRI on domestic politics and the bureaucracy), of whether resources flow into the highest national priorities, and of competition (or lack thereof) in the award of contracts. If unresolved, these issues could solidify public distrust of local leaders as well as the BRI.
10. BRI investments may not have the desired effect of bolstering the sectoral diversification of CASC economies. In fact, if not directed prudently, these investments could render CASC countries *even more reliant on commodity exports.* CASC countries also run the risk of developing an excessive dependence on China as a market for their exports.
11. Finally, while BRI connectivity projects are meant to generate new opportunities for firms in the region to trade and export their goods, they could also turn CASC countries into *transit corridors for goods traveling between China and Europe* without generating meaningful opportunities for creating local jobs.

3. Policy recommendations

There are two *primary goals* of the policy actions proposed below: first, to maximize the potential opportunities and benefits offered by the BRI to the CASC countries; second, to address the challenges and manage the risks posed by it.

To achieve these twin goals, countries in the region need to proactively take a combination of policy and institutional actions to ensure that:

- BRI investments would contribute positively to their long-term economic and social development;
- BRI projects are economically and financially viable;
- BRI projects' fiscal and debt sustainability impacts are subject to a thorough assessment. The assessment should demonstrate that these impacts are positive or, at least, acceptable;
- The O&M, environmental and social impacts of the BRI are carefully assessed and managed;
- The projects are selected, approved and bid in as transparent a manner as possible to ensure economic efficiency as well as credibility with the public at large;
- Anticipated projects are indeed realized in practice.

While policy decisions are important, so is policy implementation. Therefore, strong and independent institutions responsible for the planning, approval and oversight of BRI-related activities are critical.

For BRI investments and projects limited to individual countries, policy actions at the national level would be sufficient in most cases. However, many BRI projects (particularly connectivity projects) are regional in scope, cutting across multiple national boundaries and requiring coordination between numerous independent institutions in different countries. Their optimization and successful implementation and operation require cooperation and coordination between two or more countries. Equally important, in many critical matters it may be easier for the CASC countries to coordinate and present their concerns and positions jointly in their discussions with China rather than on a bilateral basis, given the small size of the region's economies relative to that of China. Therefore, many of the policy actions at the national level need to be complemented by actions at the regional level.

Finally, given their large size, BRI investments could have macroeconomic implications. In such cases, it will be highly desirable to coordinate discussions on the BRI with the work of multilateral institutions involved in macroeconomic analysis and policy dialogue with the countries.

Accordingly, our policy recommendations below are grouped in three clusters: actions necessary at the national level; those needed at the regional level; and actions required by China and members of the global development community.

3.1. Policy recommendations at the national level

As underscored above, it is essential to ensure that BRI projects and investments are in the countries' national interest over the long term, and that they are economically and financially sound. The assessment process should start at the planning stage when a BRI investment is first proposed and be followed with a thorough appraisal of its costs and benefits as soon as the initial investment concept is converted into a fully developed project proposal.

1. *Integrate BRI projects into national plans and priorities:* Based on country experiences within the region, it is clear that the best way to ensure that BRI investments contribute to countries' long-term development is to effectively integrate them with national plans and priorities. This was done in Kazakhstan and Uzbekistan but has not been the case in the other countries.

   Considering that many BRI investments are often relatively large compared to the overall investment programs of many CASC countries, their implementation outside the framework of the national development plans and macroeconomic management framework can lead to distortions or even wasteful expenditures, instead of making positive contributions to the national economy. Hence, countries need to give the highest priority to integrating all proposed BRI investments with their long-term national priorities and plans.
2. *Conduct rigorous cost-benefit analysis:* Once the basic concept of a proposed BRI investment is deemed to fit with the national development strategic plans and priorities, a designated national authority responsible for approving major investments should review the detailed project feasibility report, including assessments of its economic and financial viability as well as its social and environmental impact, for final approval. Governments need to ensure that project approval processes involve rigorous cost-benefit analysis.

   As part of this analysis, careful attention should be paid to each project's impact on the fiscal and debt sustainability of the host country. This is critical given the bulkiness of BRI projects, their long gestation periods and the limited fiscal and debt sustainability headroom in many countries.

3. *Focus on developing secondary and tertiary infrastructure:* CASC countries should not content themselves with the status of transit countries for goods traveling along BRI corridors between China and Europe. To ensure that BRI physical connectivity projects generate new opportunities for local businesses to participate in global value chains, policymakers in CASC countries should focus on developing and upgrading infrastructure that allows local businesses to take advantage of BRI-supported corridor infrastructure projects. To this end, CASC countries should complement investments in trunk infrastructure with parallel investments in secondary and tertiary roads and railways, as well as in the logistics facilities needed to transfer goods from secondary and tertiary connectivity to trunk routes.

   These complementary investments would not only help integrate businesses in the CASC region into the global economy and create opportunities for job creation, but also contribute to a more equitable geographic distribution of benefits from BRI investments at the country level, since regions other than those adjacent to BRI corridors could benefit from the economic opportunities they would bring.

4. *Accelerate soft infrastructure reforms within countries:* An important finding of the major World Bank study on BRI connectivity projects in Eurasia is that only about half of the benefits in terms of lower transport costs are due to the physical investments. The remaining half of the benefits result from improvements in "soft infrastructure."

   These behind-the-border reforms are fully within the control of the national authorities and can be carried out independent of the timing of individual BRI projects. Countries should therefore implement policy and institutional reforms to improve their "soft infrastructure" so as to fully benefit not only from BRI investments in connectivity but also from their existing and other planned investments in transportation.

5. *Prioritize operations and maintenance and allocate necessary resources:* All countries in the region must pay much greater attention to the long-term *operations and maintenance* (O&M) needs of the entities responsible for running infrastructure facilities, including those planned under the BRI.

   O&M is currently neglected in most countries worldwide. Within the region, this neglect has led to decay of existing facilities. If continued, this neglect can sharply curtail the useful life of expensive new assets and thus prevent the CASC countries from realizing the expected full benefits of the advanced infrastructure and industrial facilities built under the BRI.

6. *Promote greater transparency in all decisions related to the BRI:* In all country studies, lack of transparency about BRI projects (how they were decided, their exact costs, financing terms, etc.) was highlighted as a major issue. This in turn raised questions about whether the projects were properly screened and evaluated, hurting the reputations of the BRI and local public officials.

   To address this issue, countries should ensure more openness, transparency and information sharing about BRI investments. These actions will also ensure above board project selection.

7. *Ensure competitive procurement and construction contracting:* Currently, most BRI projects are proposed, financed, built and often even operated by Chinese state-owned companies. Often, these contractors also bring in Chinese workers for construction. Such bundling of services is justified on grounds of expeditious decision-making and cost effectiveness. But it also limits transparency and competition, involvement of local business groups, transfer of technical knowhow, and job creation in the home country. This is deemed untenable by segments of the local population and business community; it is already leading to resentment in some countries, although in other cases it may reflect pressures on local monopolies and other interest groups.

   As a remedy, countries should agree with China on more transparent procurement and implementation processes. These improvements would also help minimize corruption. As suggested below, it may be more effective to discuss this issue with China in a regional or a multilateral context than through bilateral discussions.

8. *Build independent domestic institutions:* Each country needs to develop domestic institutional capacity and assign clear responsibility for formulation of policies in each of the above areas for

consideration by the relevant top decision makers and for subsequent timely and transparent implementation of these policies.

These national institutions must be independent and seen as such by all concerned, as their credibility will be critical for effective policy implementation.

3.2. Policy recommendations at the regional level

A basic conclusion of the country papers prepared under the study, and of the discussions at the Forum, was that the above country-level actions need to be supplemented by effective efforts at regional cooperation and integration in order to harvest fully the opportunities presented by the BRI. The following three policy actions at the regional level are recommended towards this aim.

9. *Accelerate regional cooperation and integration:* In the last two years there have been welcome signs of greater desire and willingness among the countries in Central Asia to open their economies to each other. The heads of state-level summit in 2018 was an important breakthrough in this regard, as was the resolution at the United Nations supporting regional cooperation in the region.

   These recent political openings have raised expectations within and outside the region. Hopefully they will be followed with early concrete economic steps to accelerate progress towards enhanced regional cooperation and integration. These would include policy and institutional reforms to increase regional trade and investment flows and to build intraregional connectivity to complement the BRI. Only with such regional cooperation will the region be able to reap the full benefits of the BRI.
10. *Leverage the support of international financial institutions and other partners:* Countries should actively seek technical and financial support from other development partners (including the IFIs) to complement BRI investments in the region. This will be helpful in ensuring that the macroeconomic implications of the BRI are fully captured in the countries' overall economic policy analysis. Their assistance will also facilitate effective economic integration of the CASC countries with each other under the Central Asia Regional Economic Cooperation (CAREC) Program and with Eurasian and global markets.
11. *Create a high-level regional platform to coordinate the BRI:* Consider developing a high-level regional platform to address strategic BRI-related issues, possibly ultimately leading to a summit with the top Chinese leadership to ensure a fruitful partnership between China and the CASC region.

3.3. Policy recommendations to China and the global development community

12. *(China) Open the BRI to multilateral cooperation:* Finally, it is clear that it is highly desirable from the perspective of the CASC countries that the BRI become a multilateral initiative. China should follow through on its intention, stated at the Second Belt and Road Forum in April 2019, to open the BRI to multilateral cooperation, and IFIs should accept China's invitation to collaborate toward this end.

   This transformation of the BRI would make it much more transparent and facilitate international engagement, which in turn would address many of the issues and risks outlined above.
13. *(IFIs) Work with China to multilateralize the BRI:* The IFIs should collaborate closely with China and the countries to help them make the BRI a multilateral initiative, as the Chinese authorities have invited them to do.
14. *(IFIs) Assist the countries in assessing the impact of the BRI on their economies:* When requested, the IFIs should use their expertise to help countries in the region to analyze the costs and benefits of BRI projects on their economies.

4. Conclusion

The BRI has the potential to become one of the most transformative development programs launched since the creation of the Bretton Woods Institutions in the aftermath of the Second World War. With a membership of about 65 countries between the BRI's inception in 2013 and 2016, the initiative encompassed 132 countries as of May 2019. These countries account collectively for roughly 35 percent of global GDP, 43 percent of the global merchandise trade, and 60 percent of the world's population.

The size of ongoing and anticipated investments under the BRI is massive. In the absence of consistent official Chinese data, the EMF has estimated that between 2013 and 2018 China disbursed over US$96 billion in FDI and may have committed US$580-600 billion of loans to BRI countries. But only a very small proportion of these Chinese investments (perhaps less than one tenth of the loans) have so far gone into the CASC region, despite its vast potential and proximity to China.

The first major finding of EMF's study is that there is a good fit between the objectives of the Belt and Road Initiative and the needs of the CASC region. A major objective of the BRI is to connect the two largest economic and trading regions of the world—China (and the rest of East Asia) and Europe. The BRI also aims to facilitate the development of other emerging economies, particularly China's neighbors. The CASC region is geographically close to China and also situated at the core of the Eurasian continental space, thus making it strategically crucial for China's desire to build land-based links with Europe, whether by rail or road.

On the other hand, seven of the eight CASC countries are landlocked. They are also poorly connected with each other and the rest of the world. Their intraregional trade is among the lowest in the world. Given the above, it is obvious that the region has much to gain from the BRI's emphasis on connectivity and trade and investment flows. A positive feedback loop could start with the BRI's support for increased connectivity in CASC. The resulting reductions in transportation costs would in turn spark other significant benefits, including higher economic growth through enhanced competitiveness; greater investment and trade flows; higher fiscal revenues; enhanced productive capacity in industry and agriculture; increased tourism; technology transfer; and improved human capital and employment. Overall, if well designed and managed, the BRI can yield large payoffs to the CASC region, but this requires a genuine spirit of cooperation to attain the most out of the regional projects.

The second major finding of the EMF study is that, as with any ambitious development program, the BRI also involves significant challenges and risks for the region's economies. These risks, while common to most countries, are greater in the smaller countries and in those with weaker governance. However, independent of size, the fundamental causes of the most important risks relate to BRI investments' compatibility with national needs and priorities; their ability to yield adequate economic and financial returns to the host country; and their financial structure. Unproductive investments and badly structured projects can lead to unsustainable debt accumulation and fiscal burdens. Potential damage to the environment, use of outdated technology, lack of transparency and competition in the award of contracts, inadequate job creation and the resultant backlash among the local population were identified as other potentially serious problems in a number of countries.

There are two *primary goals* to achieve with respect to the BRI and the CASC region: first, to maximize the potential opportunities and benefits offered by the BRI to the CASC countries; second, to meet the challenges and deal with the risks posed by it.

To achieve these twin goals, countries in the region need to proactively undertake a combination of policy and institutional reforms. For policy actions to crystalize results, strong and independent institutions responsible for the planning, approval and oversight of BRI-related activities are critical.

For BRI investments and projects limited to individual countries, policy actions at the national level would be sufficient in most cases. However, many BRI projects (particularly connectivity projects) are regional in scope, cutting across multiple national boundaries. Their optimization and successful implementation and operation require cooperation and coordination between two or more countries. Therefore, many of the policy actions at the national level need to be complemented by actions at the regional level.

In addition, because BRI investments could have macroeconomic implications, it will be highly desirable to coordinate discussions on the BRI with the work of multilateral institutions involved in macroeconomic analysis and policy dialogue with BRI countries. Indeed, coordination with all significant development partners will be important under most circumstances. Finally, it is critical to have close policy dialogue with China both on a bilateral basis and at the regional level.

Many of the key takeaways (benefits, risks and policy recommendations) are likely to be relevant and apply to most other BRI countries. Therefore, even though this policy paper is focused on the CASC region, it can and should be seen as a "case study" for other regions involved in the BRI.

The main benefits, risks and policy recommendations are summarized in the graphic below.

September 2019

Key benefits, key risks, and policy recommendations

Key Benefits

- Lower transportation costs for a largely landlocked region through increased connectivity both within the region and with major markets in Europe and Asia
- Increased competitiveness, contributing to higher trade and investment flows
- Accelerated growth of the natural resource, manufacturing, agriculture, and tourism sectors
- Enhanced fiscal revenues, royalties, and transit fees from rising domestic and international commerce
- Greater inflows of Chinese capital (in excess of those provided by traditional official or private sources)
- Increased technology transfer from Chinese companies to local firms
- More human capital development
- Higher long-term economic growth and living standards for people

Key Risks

- Higher fiscal vulnerabilities and unsustainable debt accumulation, which could cause macroeconomic instability
- Insufficient attention to improvements in soft infrastructure
- Unfair benefit sharing in natural resource projects
- Inadvertent environmental degradation
- Excessive competition between major transport corridors
- Underestimation of potentially significant operations and maintenance costs over the longer term
- Limited domestic job creation due to excessive use of imported labor
- Loss of domestic productive capacity through increased foreign competition caused by greater connectivity
- Public distrust caused by poor transparency
- Threats to diversification of local economies
- Few opportunities to benefit locally from transport corridor infrastructure

Policy Recommendations

National Level:

- Integrate BRI projects into national plans and priorities
- Conduct rigorous cost-benefit analysis to ensure economic, financial, environmental, social viability of projects
- Focus on developing secondary and tertiary infrastructure
- Accelerate soft infrastructure reforms within countries
- Prioritize operations and maintenance and allocate necessary resources
- Promote greater transparency in all decisions related to the BRI
- Ensure competitive procurement and construction contracting
- Build independent domestic institutions to formulate and implement adequate policies in each area mentioned above

Regional Level:

- Accelerate regional cooperation and integration
- Leverage the support of international financial institutions and other partners
- Create a high-level regional platform to coordinate the BRI

China and Multilaterals:

China:

- Open the BRI to multilateral cooperation
- Implement decisions announced at the Second Belt and Road Forum

International Financial Institutions:

- Work with China to multilateralize the BRI
- Assist the countries in assessing the impact of the BRI on their economies

The Emerging Markets Forum was created by the Centennial Group as a not-for-profit initiative to bring together high-level government and corporate leaders from around the world to engage in dialogue on the key economic, financial and social issues facing emerging market countries.

The Forum is focused on some 120 market economies in Asia, Eurasia, Latin America and Africa that share prospects of superior economic performance, already have or seek to create a conducive business environment and are of near-term interest to private investors, both domestic and international.

Further details on the Forum and its meetings may be seen on our website at http://www.emergingmarketsforum.org

The Watergate Office Building, 2600 Virginia Avenue, NW, Suite 201

Washington, DC 20037, USA. Tel:(1) 202 393 6663 Fax: (1) 202 393 6556

Email: info@emergingmarketsforum.org