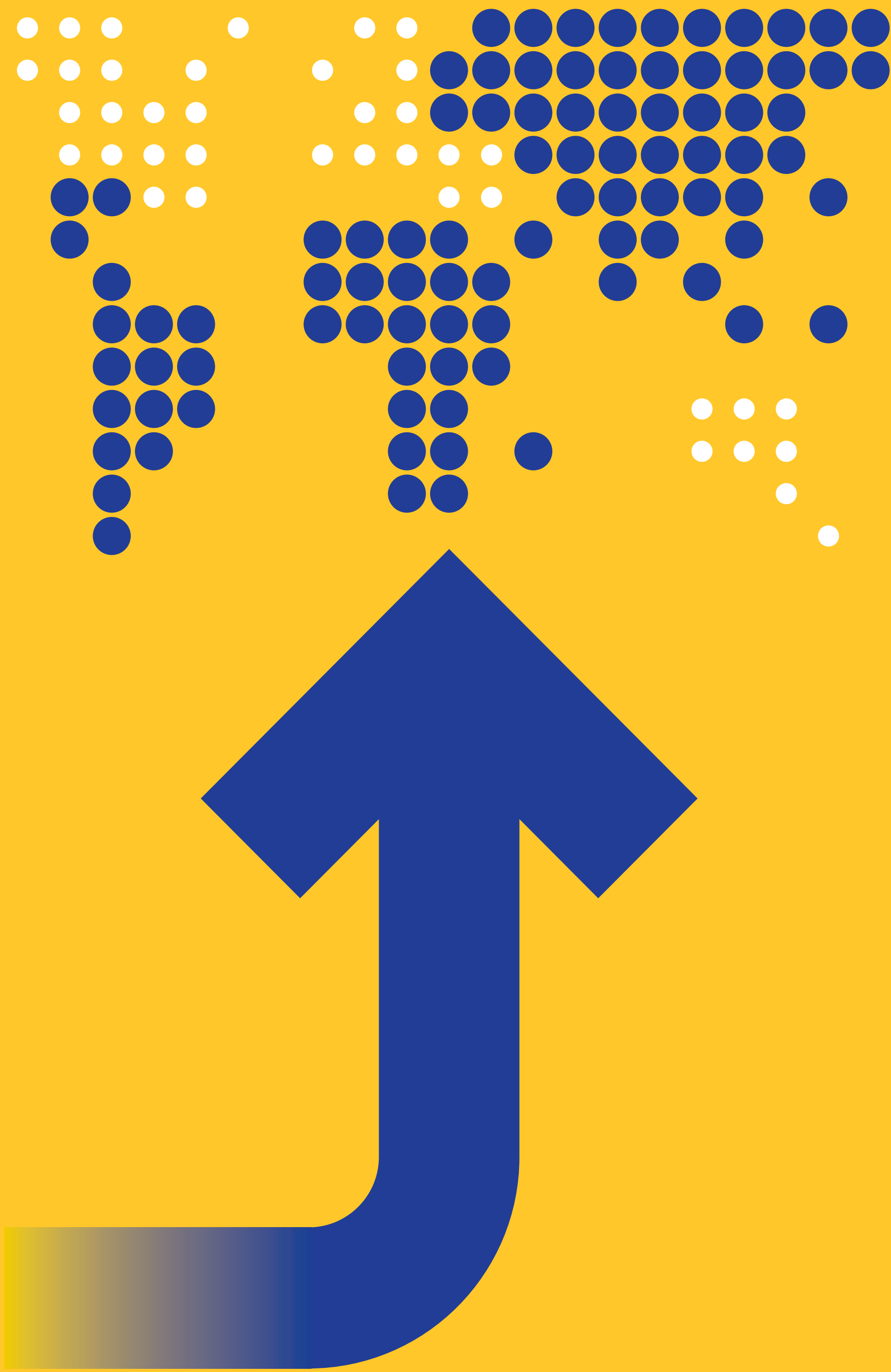

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Looking at the Belt and Road Initiative from the Central Asian Perspective

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Background Paper

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Looking at the Belt and Road Initiative from the Central Asian Perspective

An Issues Paper for Discussion at the Global Emerging Markets Forum, October 2017

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Introduction and Background

The Belt and Road Initiative (BRI) is a potentially transformational geopolitical initiative by China that goes well beyond building infrastructure along the ancient "silk road." Its current scope encompasses 65 countries[1]. These countries account for roughly 32% of global GDP, 39% of global merchandise trade, and 63% of the world's population.[2]

The BRI, also referred to as the Silk Road Economic Belt (SREB) and the 21st Century Maritime Silk Road (MSR), is a geopolitical initiative put forth by Chinese President Xi Jinping to develop a wide network of connectivity and cooperation spanning the entire Eurasian landmass and parts of Africa, including Central Asia, Southeast Asia, South Asia, the Middle East, Europe, and North and East Africa.

Under the terminology of the Belt and Road Initiative, the "Belt" refers to the surface connectivity (through the Silk Road Economic Belt) and the "Road" to the maritime routes (through the Maritime Silk Road).

Originally unveiled in 2013 at the Nazarbayev University in Astana as "One Belt, One Road," the initiative is now commonly referred to as the Belt and Road Initiative or the BRI. It is widely seen as China's landmark globalization, development, and soft power strategy and is strongly associated with President Xi's leadership. By now, BRI has become a highly visible geopolitical project: in May 2017, President Xi hosted the first Belt and Road Forum (BARF) in Beijing, which 29 Heads of State and delegations from 130 countries and 70 international organizations attended. The second BARF is scheduled for 2019.

The magnitude of investments anticipated under the BRI is massive. According to the Chinese government, $890 billion worth of investments have already been disbursed under the BRI umbrella, with an expected total Chinese investment of $4 trillion over the course of the initiative. These are order of magnitude numbers, however, as no official list of BRI projects has been released (see below).

In addition to providing direct financing for BRI projects, Chinese authorities are actively encouraging parallel financing of BRI and related activities by other parties. For example, they expect the European Union also to invest in BRI-compatible facilities within Western Europe; the EU has expressed (qualified) support for BRI. Furthermore, in early September 2017, the Chinese Prime Minister hosted a meeting of the heads of six international institutions—including the IMF, World Bank, and OECD—to discuss their financial and technical support for BRI projects. The President of the World Bank subsequently expressed support for BRI associated projects. In parallel, some international private banks, such as Deutsche Bank, have also announced plans to support BRI projects.

These developments suggest that BRI could ultimately evolve beyond a mere Chinese-financed initiative. However, the bulk of BRI related investments still appear to be conceived, driven, and primarily financed by China and financial institutions controlled by Beijing. This could change as national governments that host BRI projects, multilateral institutions, and private sector get more actively involved.

Key Thematic Areas of Focus of BRI

While development of physical infrastructure is still the most talked-about component of BRI, official Chinese descriptions of BRI mention physical connectivity as just one of five thematic areas of focus. The five areas are:

- **Policy coordination**: Planning and supporting large-scale infrastructural development projects;
- **Facilities connectivity**: Building facilities to enable connectivity along the Belt and Road;
- **Trade and investment**: Facilitating cross-border investments and sup**ply chain cooperation;**
- Financial integration: Enhancing financial policy coordination and bilateral financial cooperation;

1. Source: Menon, S. (28 April 2017). The Unprecedented Promises – and Threats – of the Belt and Road Initiative. Brookings Institution.
2. Excluding the Palestinian territories

- **Cultural exchange**: Promoting people-to-people bonds and cooperation.

One way to link the five thematic areas is to consider the BRI as an initiative focused on improving China's connectivity with some 60 plus countries in three/four continents through (1) physical infrastructure (roads, railway, pipelines, transmission networks), (2) trade, investment financial flows, and (3) people-to-people exchanges.

Currently, the five thematic areas are largely conceptual. There appears to be no official blueprint, concrete list of projects, or precise timetable. Nor is there a known formal and distinct organizational structure associated with the various projects or investments. Despite this, various institutions associated with the Chinese government assert that nearly 1,700 BRI projects are currently underway. Perhaps due to the BRI's still fluid (or flexible) nature, the Chinese government has termed this possibly historic undertaking with global implications an "initiative." Another explanation of this nomenclature is that China does not want to appear too assertive or deterministic toward potential partners.

A practical result of this state of affairs is that it permits a wide variety of Chinese entities to conceive and promote ideas and projects under the BRI umbrella, leading to intense competition at all levels within the country.

Any review of BRI's implications for Central Asia needs to be cognizant of this ambitious and broad nature of the initiative, as well as its present fluidity and flexibility.

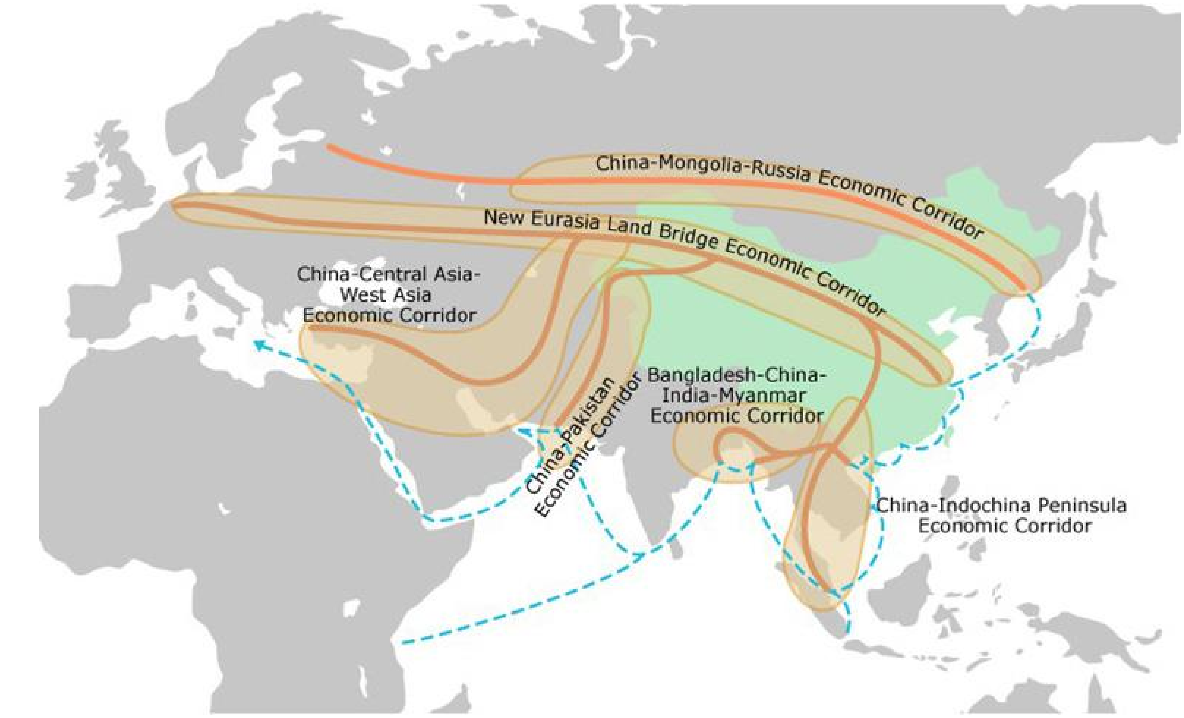
Land and Maritime Corridors under BRI

Under the thematic area of connectivity, seven key land and maritime corridors are currently included in the BRI:

- New Eurasian Land Bridge, from Western China to Europe
- China-Mongolia-Russia Corridor, from Northern China to Eastern Russia
- China-Central Asia-Western Asia Corridor, from Western China to Turkey
- China-Indochina Peninsula Corridor, from Southern China to Singapore
- China-Myanmar-Bangladesh-India Corridor, from Southern China to India
- China-Pakistan Corridor, from South-Western China to Pakistan
- Maritime Silk Road, from the Chinese coast/South China down to Singapore and across to Mediterranean through Indian Ocean, Arabian Sea, and Red Sea

While the popular names like the "new silk road" imply that the connectivity component of BRI involves mainly routes through Central Asia, in reality only two of these seven corridors traverse the five countries comprising the Central Asia region, as shown in the map below.

Figure 1: Map of Belt and Road Initiative Corridors



Source: Hong Kong Trade Development Council

Implications for Central Asia

The emergence of the BRI over the last three years has created a new reality for Central Asia's development and for the prospects of economic integration in the region, as well as for the broader Asia-Europe-Middle East-East Africa economic space. This new reality needs to be explored in-depth and its significance for Central Asia understood more fully.

While many investigations of the nature and significance of BRI have been recently published or are ongoing, very few–if any–specifically address questions such as what BRI means for Central Asia, what types and quantities of investments are likely to be supported by BRI in the region, what specific benefits and risks BRI might represent for Central Asian countries, and how these countries might best manage the design and implementation of BRI-supported investments in their countries to obtain maximum sustained development benefits.

While infrastructure development and investment would and should be the obvious starting point in assessing the BRI's impact on Central Asia, initiatives under three of the other four thematic areas also deserve careful consideration (the cultural exchange theme can perhaps be reviewed separately). Indeed, from an economic development and job creation perspective, trade and investment, as well as financial flows and integration, may ultimately turn out to be even more crucial; construction of connectivity corridors and reduction of transport costs should be regarded as a means to an end and not an end in and of itself. Additionally, in any broad-based dialogue between China and Central Asia on the scope and direction of BRI, policy coordination would be crucial.

There are three reasons for looking at BRI from the perspective of the entire Central Asia (CA) region instead of looking at it from the perspective of each Central Asian country individually. First, the BRI is a continental initiative cutting across all five Central Asian countries and linking them to their Eastern, Western, and Southern neighbors, as well as to each other. It is almost impossible—analytically and economically—for any CA country to look at BRI's impact on itself in isolation of the initiative's impact on its neighbors. Second, the size of China's economy, trade, and markets is massive relative to those of individual CA countries; so too will be its leverage. Any discussion of the BRI is likely to be more productive if held between the five CA countries as a group and China, rather than on a bilateral basis. And third, there are significant economies of scale in assessing the impact of BRI on all five CA countries in one single study rather conducting five separate studies.

The focus on the Central Asia region would obviously encompass the five former Soviet republics (Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan). But given the configuration of various BRI corridors and activities of other actors in the region (see below), discussion of the implications of BRI's engagement in neighboring countries such as Mongolia and Afghanistan, as well as in the Caucasus region, would also be desirable, though perhaps in lesser detail.

What do other regional and global actors have to offer Central Asia?

China is not the only external actor important to Central Asian economies. While reviewing the BRI's economic and social implications, Central Asian countries also need to keep in mind the role other regional and global actors play in promoting connectivity, trade, investments, and financial flows, as well as workers remittances (which are a major source of external earnings for some of these countries). The options before Central Asia and the questions to be addressed in this regard include:

- What alternatives to the BRI are Russia, the EU, India, Iran, and Turkey undertaking in parallel to China, and what complementary initiatives to the BRI can these third countries potentially offer?
- How will BRI affect the geopolitical balance of Central Asia with its neighbors? Is another Great Game in the offing?

The following paragraphs give a brief comparison of the economic ties between the five Central Asian countries and seven of their partners—Russia, the European Union, Turkey, India, the southern Persian Gulf states, Iran, and China—in terms of imports, exports, FDI, and remittances. Table 1 also summarizes the numbers.

As would be expected, for historic reasons Russia remains an important economic partner of the region. But Russia is no longer as dominant an economic partner as in the past both because its own economy has waned and because others made strong inroads (even before the BRI was announced). Central Asia's ties with Russia are distinguished by the importance of remittances sent home by guest workers from the region that have migrated to Russia. For some countries—Tajikistan, Kyrgyzstan, and to a lesser degree Uzbekistan—these remittances represent a major if not the single largest source of foreign exchange. In terms of physical connectivity, robust infrastructure links created during the Soviet era still exist between Russia and

Table 1: Central Asia's Economic Partners (USD millions)

	Exports to Central Asia		Imports from Central Asia		FDI Outflows to Central Asia		Remittance Outflows to Central Asia	
Year	**2010**	**2015**	**2010**	**2015**	**2010**	**2015**	**2010**	**2015**
Russia	9105	15897	4840	5566	3570	3130	2554	6257
European Union	9968	10315	22296	18893	36288	48011	73	353
China	13165	14502	13404	14522	2694	4452	0	4
Turkey	2514	3554	4033	2659	1023	752	5	11
India	273	422	218	452	20	20	n/a	n/a
Gulf States	203	178	353	232	n/a	n/a	n/a	n/a
Iran	165	205	479	260	n/a	n/a	n/a	n/a

Source: Centennial Group International

each of the countries in Central Asia and the Caucasus. In 2015, Russian exports to the region still exceeded those of all other countries.

The European Union has by now become by far the largest export market and source of FDI for the region as a whole. The EU has gained this status due to its close commercial ties with Kazakhstan, particularly in the energy sector. The EU is not yet the largest export market for other CA countries, however. Workers' remittances from the EU are also very modest. Private sector business entities and banks conduct the EU's trade and investment activities, albeit with the encouragement of the EU.

China's economic relations with Central Asia were already growing with the rise of energy imports even before the BRI, but the pace has accelerated ever since the initiative's launch. In terms of numbers, Chinese imports from CA are now the second largest (after the EU), while it was the second largest exporter to the region (after Russia). China is also the second largest source of FDI (after the EU). Chinese economic ties with the region are driven by state funds and state-owned enterprises.

Turkish economic activities rank a distant fourth and are mainly carried out by private Turkish companies (construction and services). Its exports, fourth after the EU, far exceed its imports from the region, while its FDI flows are still very modest. The country has also launched a political forum to bring together Turkic-speaking countries in the region (Cooperation Council of Turkic Speaking States: CCTS) but it is not yet as prominent as the one Russian initiative (the Eurasian Economic Union) and the two Chinese initiatives (the Shanghai Cooperation Organization and the Belt and Road Initiative) that include Central Asian countries.

More recently, India has launched efforts to develop closer economic and political relations with Central Asia, in part to tap its rich energy resources. India has announced an ambitious initiative to develop comprehensive links throughout Central Asia through the so-called North-South Transport Corridor (linking Mumbai with St Petersburg) that in theory could offer some competition to the BRI. In addition, India is promoting the Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline. It has also announced plans to invest in Iran's Chabahar port, which lies only one hundred miles away from the southern terminal of the China-Pakistan Economic Corridor in Gwadar. But, except for the start of construction on the TAPI pipeline, the results on the ground of these Indian efforts have been meager thus far. Its economic ties still remain modest relative to those of the EU, Russia, China, and even Turkey. Unlike China, India's development assistance budget is small and is concentrated mainly on Tajikistan (which received almost 70 percent of India's small foreign aid grant budget). The main reason for India's modest trade and investment relations with Central Asia has been its inability so far to achieve a breakthrough in the largest economy in the region: Kazakhstan has yet to award India a significant oil or gas deal, be it for imports or production.

Table 1: Central Asia's Economic Partners (millions USD)

Source: Centennial Group International

Finally, the region's economic interactions with the Persian Gulf states (comprising the six members of the Gulf Cooperation Council: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) and Iran remain very modest. In the case of the former, this is mainly due the structure of both regions' economies, though the numbers may understate the extent of actual flows of trade and investments because of incomplete data. The Gulf countries are quite active in the region, however, through cultural and religious patronage (as is Turkey). In the case of Iran, despite its proximity and large economic size, its economic relations with Central Asia are negligible. This may be due to historic distrust of Iran during the Soviet era, concerns about the religious fervor of its regime, and international sanctions due to its nuclear program. It is unclear how the

2015 P5+1 nuclear deal and lifting of sanctions combined with closer relations with Russia will impact Iran's future economic relations with Central Asia.

In summary, while China's BRI has huge implications for Central Asia, it is not the only external source of trade, investment and finance for Central Asia. The question then is how should the region consider the potential opportunities, benefits and risks associated with BRI within this broader context.

Looking at the BRI from the Central Asian Perspective: Key Issues

Looking at the Belt and Road Initiative from the perspective of Central Asia will essentially involve assessing the likely economic and social benefits, costs, and risks of the BRI on Central Asian countries, and identifying strategies, policies and approaches that would help increase its benefits and minimize its risks for the region.

While the primary focus of such a review will be on physical connectivity aspects of BRI (planning, construction, and operation of infrastructure facilities), it will also cover the three other thematic areas of focus of BRI—policy coordination, trade and investment, and financial investment/flows. Such a holistic review will allow a comprehensive understanding of the implications of BRI for Central Asia's development prospects, economic integration, and global connectivity.

In this context, the issues and questions that appear to require priority attention include the following:

Physical connectivity

- *Costs and benefits of improving transport and energy infrastructure*: China has already proposed seven transport corridors, of which two cut across Central Asia and one goes through Mongolia to Russia. In addition, a number of oil and gas pipelines are part of BRI. An important building block for the review will be compiling a complete list of these and other infrastructure projects and reviewing their scope and routing, timing, impacts (social and environmental) likely costs and financing sources, including fiscal burdens on the CA countries for both capital and operating and maintenance costs), implementation arrangements, planned role of the host country/countries, and expected benefits to CA countries. The relationship—complementarity, overlap, or duplication etc.—of these BRI projects with similar initiatives of other partners in the region will also require a careful look.
- *Implications for improving trade logistics*: Experience from elsewhere demonstrates that actual realization of the expected benefits of infrastructure facilities linking different countries (reduction of transport costs, increase in regional trade and investment flows) depends critically on improvements in "soft infrastructure" or trade logistics and removal of "behind-the-border barriers." Such improvements will require close policy coordination between China and the Central Asian countries, as well as with countries where transport corridors will ultimately lead after crossing Central Asia. The review will identify key issues and highlight the policy measures that each party will need to take.
- *Are the current routes and project scopes optimal from the CA perspective*: A key issue to be examined for the major BRI projects, including parts of the transport corridors where construction has not yet started, will be whether the routes and project scopes as currently proposed are optimal from the perspective of the CA countries concerned, and if not, what alternative routes and/or project scope CA policy makers should explore with their Chinese counterparts in order to improve the project benefits and/or reduce risks so as to create more win-win outcomes.
- *Transport vs. economic corridors, and job creation:* It appears that as presently advocated, the seven corridors were conceived primarily as transport corridors to link China with Europe, the Middle East, the Gulf, East Africa, or Southeast Asia. We also know from the Asian Development Bank's work in the ASEAN region that from the development and job creation perspective, it is much more desirable to conceive of such regional connectivity projects as broader economic corridors rather than mere transport corridors. One such successful example in the Greater Mekong Sub-region is the corridor linking Hanoi (Vietnam) to Bangkok (Thailand) and passing through Laos and Cambodia. Doing the same in Central Asia along the old Silk Road may be worth consideration, but may require modifications in the proposed routing of the corridors. The key question is whether the Chinese promoters of the corridors are open to such basic changes in concepts at this stage.
- *Implications for enhancing CA integration*: For years, many people in the region have advocated closer regional integration. In recent months there

have been signs that regional integration is perhaps more politically feasible than in the past. The question then is how, if at all, would the BRI facilitate, or even help address, regional integration in areas such physical and ICT connectivity, water, tourism, or climate change.

- *Implementation arrangements*: What is the institutional capacity of Central Asian governments to implement the investment programs envisaged under BRI? How will the O&M requirements of BRI programs be managed from both an organizational and a fiscal policy perspective?
- *Debt management/long term fiscal implications*: As noted earlier, the BRI implies a massive scale of investments. It is therefore important to examine the macroeconomic implications of BRI investments for Central Asia in terms of fiscal effects, debt levels and service requirements, possible exchange rate effects, economic growth and equity, etc.
- *Lessons from Chinese assistance for infrastructure development in Africa*: During the past decade, China has undertaken major initiatives in a large number of African countries to develop infrastructure facilities, including roads, railways, ports, airports, and public facilities. Some reports suggest that as much as half of all major infrastructure projects built in Africa in the past few years have been carried out with Chinese assistance; their costs and completion times are reportedly much lower than those of projects supported by Africa's traditional donors. At the same time, there are questions about the financial and physical sustainability of the Chinese-built projects. In a few countries, many Chinese workers who built the projects decided not to return to China, which caused social tensions (at least initially). Given the massive size of the proposed BRI investments in Central Asia and their potential economic, environmental, and social impact on the host countries' relatively small populations, it may be worthwhile to review the lessons learned from Chinese engagement in Africa so as to identify and avoid deleterious practices that might be repeated in Central Asia.

Trade and Investment

- *Critical importance*: Physical connectivity and improvements in infrastructure development are a critical building block for economic progress, but they are not the end objectives by themselves. They are meant to facilitate greater trade and investment in all sectors of the economy: in manufacturing, in agriculture and agro-industry, in services, in tourism, and so on. The main payoff to Central Asia from the BRI could be a much greater flow of trade and investment not only from and with China but also from the other countries—including in Europe, the Middle East and South Asia—that will ultimately be connected through the BRI. This could be a major externality of the BRI for the Central Asian economies. Similarly, additional trade and investment flows should be anticipated across Central Asia. In other words, BRI's impact on Central Asian economies would go well beyond their direct economic relations with China and must be taken into account. It is thus obvious that any review of the BRI's implications for Central Asian countries should pay careful attention to how the initiative could impact trade and investment both directly and indirectly and what measures the host countries can take to maximize the potential benefits of BRI to their economies.
- *Policy reforms and coordination*: These desired additional trade and investment flows would not come about automatically. Much as improved trade logistics are necessary to reap the benefits of cross-border infrastructure, increasing trade and investment flows will require both domestic policy and institutional reforms and policy coordination between countries.

Financial Flows and Integration

- *Opportunity to tap China's vast financial resources*: With over $3 trillion of foreign exchange reserves, by far the world's largest, and a national savings rate still exceeding 40 percent, China has huge financial resources. Chinese authorities and asset managers are looking for opportunities to invest some of these resources outside China. Even if a small fraction of these resources could be attracted to Central Asia, it will make a huge difference to the region--provided, of course, that the resources were invested consistent with the host countries' needs and priorities. The question is how best to achieve this objective given the relatively small size of the financial and capital markets in most countries.

- *Integration of financial markets*: China is aggressively moving ahead with the development of its domestic financial markets and the creation of a major financial center in Shanghai in addition to the existing financial hub in Hong Kong. Under the BRI framework, China also envisages financial integration with a much larger group of countries. Given Central Asia's proximity to China and its much smaller financial system, these Chinese intentions offer vast opportunities but also potential threats to the existing players in Central Asia and their plans (Astana International Financial Center). Integration of financial systems within Central Asia and China, while potentially attractive, would require addressing a host of complex policy and technical issues that require careful review. The key question is what the Chinese authorities have in mind for Central Asia under the BRI's financial integration theme.

The answers to these questions will give a sense of the overall implications of BRI for Central Asia; the potential benefits, costs and risks; and how governments and other stakeholders in the region can best assure that net benefits for Central Asia are maximized and risks effectively managed.

Issues for Discussion at the Forum

This Issues Paper will be discussed at the forthcoming meeting of the Emerging Markets Forum. The Forum participants will be asked to provide feedback on two basic questions: (i) whether or not they agree with the basic premise behind the paper that it is worthwhile to look at the BRI from the specific perspective of Central Asia despite the plethora of other studies underway on the BRI; (ii) whether the list of issues discussed above is adequate or needs modifications, and if the latter, of what kind; finally, iii) what does BRI mean for the Central Asian countries when all these factors are taken into account?

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 70 market economies in East and South 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. Our current list of EMCs is shown on the back cover. We expect this list to eveolve over time, as countries' policies and prospects change.

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