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The Impact of the Belt and Road Initiative in Central Asia and the South Caucasus: "Inside-out" Perspectives of Experts from the Region

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Background Paper



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Preface

Johannes F. Linn and Leo Zucker

The Belt and Road Initiative (BRI) is a development program undertaken by China, beginning in 2013, with a global reach and potentially far-reaching economic and geopolitical implications. Much has been written about various aspects of the BRI since its inception, with a lot of speculation on China's motives in launching the initiative, its current and expected future scale, and its possible impact on participant countries. Most of the literature on this topic has been contributed by experts and journalists from industrialized countries and based on the limited information available on the BRI at a global level. Little has been written by experts from the participating countries based on country- and region-specific information; an "inside-out" view of the BRI is needed.¹

The Emerging Markets Forum, with financial support from the Swiss National Bank, has undertaken a study of the BRI's impact on the eight countries of the Central Asia and South Caucasus (CASC) region with the goal of filling this gap. It has commissioned country notes prepared by five experts in the region. Each author was asked to respond to a structured set of questions about the scope of the BRI activities in her or his country (or countries, in the case of the South Caucasus), their terms of financing, the potential benefits and risks associated with the initiative, and relevant issues that warrant future research. All countries in the region, except Turkmenistan,² are covered by the five notes: four notes cover Kazakhstan, the Kyrgyz Republic, Tajikistan and Uzbekistan, respectively, in Central Asia, and one note covers Armenia, Azerbaijan and Georgia in the South Caucasus. These notes are compiled in this Working Paper.

We are very grateful to the authors of these notes for contributing their expert insights to this study. The papers differ in the extent to which they provide in-depth data on BRI activities given considerable differences in availability

of information across countries. They do, however, show the great variation of the extent of engagement with the BRI in the CASC region to date and shed new light on the scope of the BRI and on its potential benefits and risks.

The Emerging Markets Forum has also commissioned a set of five background notes on the perspectives of five outside powers (China, Russia, the European Union, India and the United States of America) on the BRI in the CASC region. These background notes have been compiled in a separate Emerging Markets Forum Working Paper.

Based on these ten background notes and on additional research, we have prepared an overview paper which provides an assessment of what we know about the BRI in the CASC region, including its potential benefits and risks (as seen from the perspectives of participating countries), how outside partner countries are likely to engage with it, what policy responses are appropriate, and what issues could be usefully addressed by future research.

1. See the comprehensive annotated bibliography compiled for this current study: <http://www.emergingmarketsforum.org/wp-content/uploads/2018/10/BRI-Annotated-Bibliography-2018-10-19.pdf>

2. We did not commission a note on Turkmenistan since we could not readily identify an independent local expert and also judged the likelihood of accessing usable information as very low.

The Belt and Road Initiative: The Case of Kazakhstan

Aktoty Aitzhanova

1. Overview

The Belt and Road Initiative (BRI) was announced in Astana only five years ago, in September 2013, and it is hardly possible to assess the economic effects of the Initiative on individual countries, and even more so in the case of Kazakhstan. Many of the activities announced under the Initiative are just completing the stages of preparation and appraisal and only now are moving to the implementation phase. Others are still at the bilateral discussion and exploration stage.

The BRI has predictably drawn different opinions. A wide range of issues are associated with BRI projects, particularly with respect to the lending terms that Chinese public sector financial institutions offer to participating governments (high interest rates); the turn-key character of the projects, i.e. construction by Chinese companies employing mostly Chinese workers; relocation of pollution-intensive production from Chinese territory to other states; and the resulting increase in social tension in the respective host states. Against this backdrop there is a growing perception that the BRI brings substantial risks to the development of the participating states, and that it is focused just on strengthening China's position.

When discussing Kazakhstan's case, perhaps the obvious assumption is that these same issues listed above apply to Kazakhstan as well in its interaction with China over the BRI. However, in the author's view, the case of Kazakhstan is different.

First, Kazakhstan and China had established close economic relations long before the BRI. Among the CIS countries, Kazakhstan has been and remains the largest recipient of Chinese foreign direct investment. This is primarily due to China's interest in Kazakhstan's oil and gas industry. Accordingly, with the fall in energy prices over the past four years, trade between Kazakhstan and China decreased as well.

Second, with the BRI, economic cooperation between Kazakhstan and China has become much more diversified, considering the expansion of collaboration in agriculture,

industry, finance, services, transport and logistics. Many projects in these areas are still being negotiated, and certainly the amount of financing required is not comparable with that of projects in the oil and gas industry, so they have not affected the decline in mutual trade over the past few years.

Third, after the announcement of the BRI in 2013, the first formal agreement on an investment in production capacities was established only in 2015 in the form of setting up a working group. Ever since, the two states have been negotiating, and only by the summer of 2018 was a document signed that sets forth the intent for cooperation over the next five years in the sphere of production capacities. The available list of projects reflects Kazakhstan's desire to attract high-quality and clean production to its territory, to modernize existing industries, and thereby accelerate industrial development with the involvement of Chinese investors.

Fourth, in infrastructure, Kazakhstani experience with a programmatic approach stands out. In 2014, Kazakhstan initiated its own program of infrastructure modernization ("Nurly Zhol" Program) and invited international financial organizations such as the World Bank, the Islamic Development Bank, the Asian Development Bank, and the European Bank for Reconstruction and Development to participate. A year later, the Governments of Kazakhstan and China signed an agreement tying together Nurly Zhol and the BRI, which allowed China to become one of the participants in Kazakhstan's infrastructure modernization. Some preliminary results are now visible. Over these four years, Kazakhstan has built several international logistics centers from scratch and built pipelines and railways linking the country's oil and gas resources in the West with the East across the border with China. In parallel, Kazakhstan also intensified its physical connectivity with Iran and Turkey. Thus, Kazakhstan is starting to establish a diversified transport network with its neighbors and other markets beyond.

Fifth, cooperation is also intensifying in finance. The most common form of funding projects takes the form of

capital investment by creating a joint venture. Financial institutions providing funding include the China Development Bank and the Export-Import Bank of China (CHEXIM), as well as the Development Bank of Kazakhstan (KDB).

In this context, and of course keeping in mind that BRI has only a history of 5 years, this initiative shows great promise, at least for Kazakhstan, provided the investments will be developed, financed and implemented in true partnership. One should however note that experts mainly based in Europe and the United States tend to voice skepticism about the prospects of actual BRI implementation, first of all, because of increasing competing claims on China's financial resources as it tries to balance between pushing out more credit to the economy to maintain growth while also slowing the accumulation of debt by all actors and trying to tighten financial supervision. In addition, other acute challenges, such as the impact of the current US-China trade war and management of US-China relations overall, as well as geopolitical uncertainties involving most big neighbors of Kazakhstan, cast a pall over the region's economic prospects.

The author will address all these questions pertaining to Kazakhstan-China relations in the following sections of the document. Section 2 provides a brief overview of bilateral trade relations as a "place-setter," as it explains the context that has shaped Kazakhstan's BRI approach. Reminding readers of the five pillars of the BRI, i.e. (i) policy coordination, (ii) infrastructure and logistics for connectivity, (iii) trade and investment, (iv) finance, and (v) people-to-people exchanges, Section 3 describes the policy framework Kazakhstan has embarked on—with or without BRI—and also reviews the key infrastructure projects and connectivity initiatives. Section 4 examines the current state-of-the-art investments in the productive sectors of the economy, called "51 projects" in Kazakhstan, followed in Section 5 by an assessment of recent innovations in the financial sector to promote closer bilateral ties. Finally, following a brief reference to people-to-people cooperation in Section 6, the author presents the results of a 2017 survey conducted by the National Analytical Center on Kazakhstani citizens' perception of China in Section 7. Section 8 concludes.

2. Bilateral Trade in the Post-Soviet Period

Kazakhstan and China have been strategic partners since the 1990s. Among the countries of the former Soviet Union, Kazakhstan remains the largest recipient of direct foreign investment from China. Since 1991, China has invested US\$16 billion in Kazakhstan, mostly in the oil and gas sector (Shibutov 2018).

In terms of Kazakhstan's foreign trade relations, China ranks second overall after Russia. China's share of Kazakhstan's external trade is approximately 15-18 percent. China is among the largest recipients of Kazakhstan's exports, about half of which come in the form of crude oil, as well as uranium and radioactive elements, copper, copper ore, iron ore, ferroalloys, zinc, and petroleum products. 253 types of products, combined into 66 groups, are exported to China, whereas China overall imports about five thousand types of goods. As for imports, China again ranks second (Shibutov 2018).

The biggest Chinese companies such as SINOPEC and other companies are represented together with other multinational companies in virtually all key oil fields of Kazakhstan. According to the Statistical Committee, in Kazakhstan as of July 2018, there were 846 Chinese companies and 422 joint companies; on this variable, China comes third after Russia (8,900 companies) and Turkey (1,900 companies). However, Chinese firms are the dominant developers in certain regions with mature oil fields where production is expected to go down. China is present in the drilling industry via the "Kazakhstan-China Drilling Company," the founder of which is the "Great Wall"¹. Yet, still 71 percent of oil is exported through the Caspian Pipeline Consortium, and the rest divided between Atyrau-Samara and Atasu-Alashankou².

Reflecting the collapse of oil prices in 2014, in recent years trade between Kazakhstan and China has dropped dramatically (Table 1). Kazakhstan's trade surplus with China fell from US\$6 billion to US\$1 billion. FDI dropped as well (Figure 1).

This drop in foreign trade was observed in relation to all trade partners of Kazakhstan. The fall in exports affected GDP growth, which was stuck at less than 2 percent in 2014-2016 (Figure 2). As a result of the oil price collapse and stagnation in GDP growth, tax revenues fell, and the Tenge, the national currency, went through a significant depreciation that led to higher inflation. In response to these external shocks, Kazakhstan announced a countercyclical large-scale (close to US\$1 billion) infrastructure investment program called Nury Zhol ("Bright Path") aimed primarily at mitigating the consequences of falling oil prices.

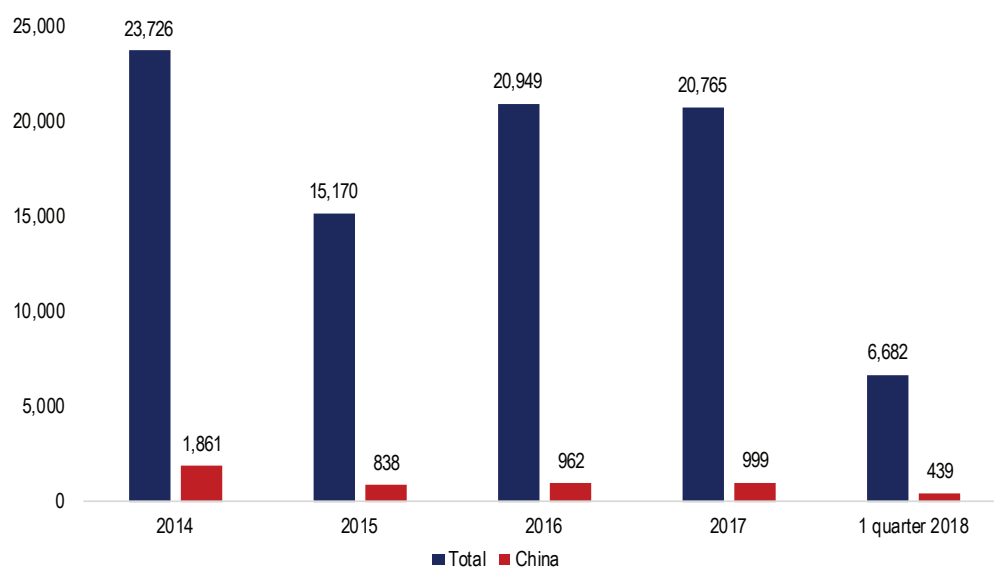
1. Based on information on economic cooperation with China published by the Committee on Statistics of the Ministry of National Economy in 2016.

2. Based on a Report of the Minister of Energy of the Republic of Kazakhstan, published on the website <http://kz.energo.gov.kz/index.php?id=2>

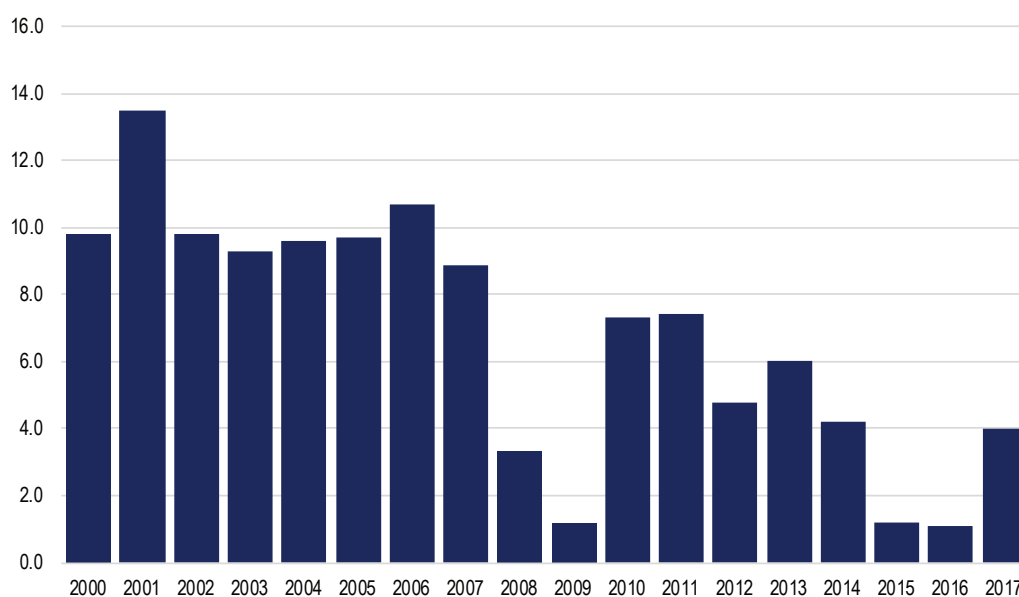
Table 1: Kazakhstan and China, Foreign Trade Indicators (US\$ millions)

| | 2013 | 2014 | 2015 | 2016 | 2017 |
|------------------------------------|-----------|----------|----------|----------|----------|
| Exports to China | 14,373.70 | 9,799.40 | 5,480.10 | 4,214.90 | 5,777.70 |
| China's share in exports, % | 16.97 | 12.33 | 11.93 | 11.46 | 11.95 |
| Imports from China | 8,364.50 | 7,357.20 | 5,087.80 | 3,665.70 | 4,692.20 |
| China's share in imports, % | 17.14 | 17.82 | 16.64 | 14.56 | 15.99 |

Source: Shibutov (2018)

Figure 1: FDI Flows to Kazakhstan (US\$ millions)

Source: National Bank of Kazakhstan

Figure 2: Kazakhstan's GDP Growth since 2000 (%)

Source: Committee on Statistics of the Ministry of National Economy

3. Kazakhstan's Decisive Policy Initiative: Large-scale Infrastructure Program Nurly Zhol

In 2014 Kazakhstan initiated the major infrastructure program Nurly Zhol, designed to remove existing infrastructure constraints and bottlenecks in road, railroad and air transport, as well as in port and terminal logistics. This was to allow Kazakhstan not only to fully integrate into international transport flows and networks, but also to lay a solid foundation for further industrialization by fostering economic corridors. In other words, the program aimed to develop Kazakhstan as a overland as well as air transport hub and thus make the country a real transcontinental transport corridor linking East Asia with Europe and, in the future, South and South East Asia with Europe. This program was financed by the National Fund of Kazakhstan. Nurly Zhol was complemented by partnership agreements with international financial institutions (IFIs) such as the World Bank, Asian Development Bank, Islamic Development Bank and the European Bank for Reconstruction and Development (OPM 2018). The total budget of this program for 2015-2018 is estimated at around US\$16 billion, with co-funding from international organizations estimated at almost US\$9 billion.

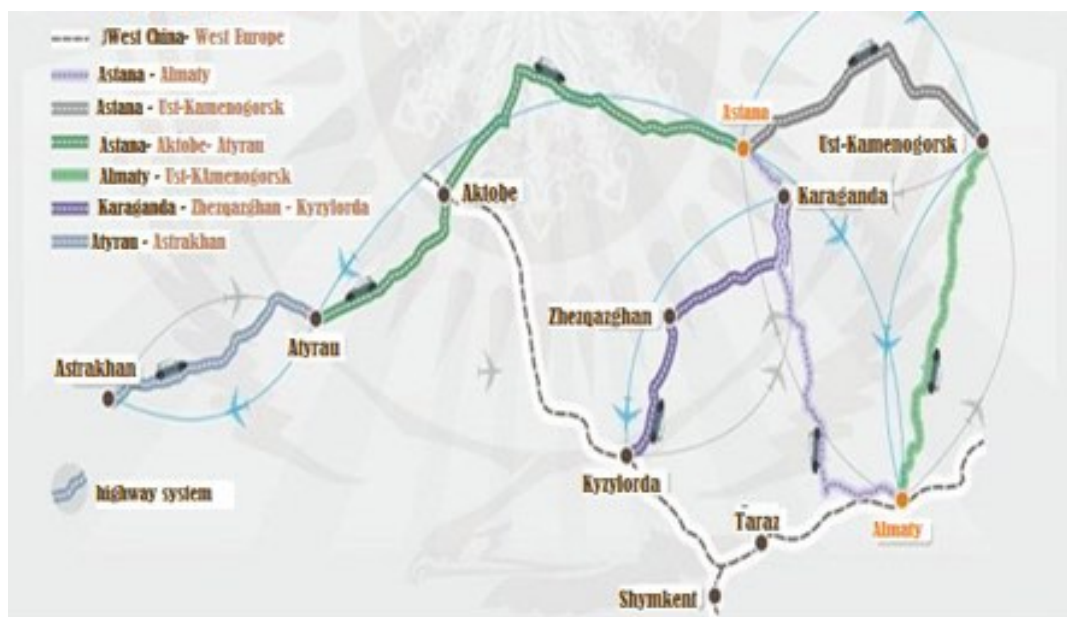
A year later, in 2015, the Government of Kazakhstan approved the Plan for the Integration of Nurly Zhol with the implementation of the BRI (Government of Kazakhstan 2016b). After this, China became one of the partners of the

infrastructure development initiative, along with Kazakhstan and the World Bank, IDB, ADB, and EBRD.

Within this framework, multiple transit routes connecting Kazakhstan with China and Russia—such as (1) Western Europe-Western China, (2) Omsk-Pavlodar-Maykapshagai, (3) Astrakhan-Atyrau-Aktau-Turkmen border, (4) Shchuchinsk-Kokshetau-Petropavlovsk, (5) the border of the Russian Federation-Uralsk-Aktobe, (6) and Astana-Kostanay-Chelyabinsk—underwent modernization and construction (OPM 2018) (Figure 3). From 2015 to 2017, 4,400 km of roads were built, and by 2020, 7,400 km of new roads are planned to have been built in total. During 2015-2017, the freight turnover between regions within Kazakhstan increased 2.5 times (from 12 to 30 million tons), and transit road transport increased 3 times (from 350 thousand tons to 1 million tons) (OPM 2018).

In addition to roads, under Nurly Zhol an additional 1,376 km of railways were built, which increased the capacity and speed of goods transport to new domestic markets. Two railway lines in particular, namely Beineu-Shalkar and Zhezkazgan-Saksaulskaya, connect the West of the country with Dostyk (East) and Khorgos (Southeast), two key border checkpoints with China (OPM 2018). In February 2017 another alternative route was opened, linking China and Iran via Turkmenistan (Ministry of Railways 2018). On June 26, 2018, the opening ceremony of the multimodal transport corridor China-Kazakhstan-Iran took

Figure 3: Nurly Zhol Projects



place. This corridor begins as the East China-Dostyk-Zhezkazgan-Beyneu railway and leads to the seaport of Aktau, with access to the port of Anzali (Bnews 2016).

Lastly, with Nurlı Zhol, Kazakhstan could construct four logistics centers (Box 1): Lianlungan International Logistics Park, the dry port of the FEZ Khorgos-Eastern Gate, International Center Khorgos, and the Kuryk Sea Port on the Kazakhstani shore of the Caspian Sea. The opening of these logistics centers has significantly improved the transit potential of the country. Whereas in 2010 no containers from China crossed the territory of Kazakhstan to deliver cargo to Europe, in 2011, 1,200 containers were transported through Kazakhstan. By 2014, the fees for this itinerary started to be quoted in trade publications, and in 2017 the number of containers had already reached 200,000. Projections for 2019 indicate 800,000 containers, growing to 2 million containers by 2020 (KTZ 2018). This alone should generate US\$5 billion in transit revenue annually (Duparq 2018).

With all these projects implemented, Kazakhstan could integrate into three transport corridors within the BRI framework: China-Kazakhstan-West Asia, China-Kazakhstan-Russia-Europe, and China-Kazakhstan-Turkey-Europe (Government of Kazakhstan 2016b)³. Improvement of infrastructure had a positive impact on the country, as Kazakhstan's ranking in the World Bank's Logistics Index moved up from 88th position in 2013 to

71st in 2018 (World Bank 2018). Kazakhstan ranks higher than Russia, Belarus and other Central Asian countries, as well as many other upper middle-income countries. In the medium and long term, it is expected that there will be a positive effect on the growth of those regions of Kazakhstan located along trade routes due to better access to markets for local producers and employment. A recent World Bank study identifies Almaty, Astana, Atyrau, Aktau, Shymkent, Kokshetau as regions of Kazakhstan where the BRI can potentially decrease trade cost between 2 and 7 percent, which is to increase income in these regions by 5-10 percent (Lall 2018). What is noteworthy is that China's participation in the construction and modernization of these projects has been modest; Kazakhstan continues to implement most of the projects at its own expense. For example, construction of 16 highways was started in 2017; 9 of them are financed by the Government of Kazakhstan, 5 are financed in cooperation with IFIs, and only 2 are funded by CHEXIM (OPM 2018). Dubai's DP World and China's COSCO jointly manage the logistics centers; however, there is no open source information available on the amount of investment provided by China and terms of financing.

The World Bank suggests that infrastructure projects have already contributed to a reduction in shipping costs of 5 percent and in waiting time at the border of 13 percent in Kazakhstan, which has led to an improvement in mutual trade between the countries of the Initiative—in the case of Kazakhstan by 4 percent (Ruta 2018). Based on the World Bank's CGE model, facilitation of trade between countries

3. One should note that the first corridor cited and parts of the other two had already been identified as CAREC Corridors (CAREC standing for Central Asia Economic Cooperation Program, an international partnership launched in 2001).

Box 1: About Logistics Centers

The International Center Khorgos (ICK). The Government of Kazakhstan invested only US\$143 million; US\$2.5 billion have come from private sources. ICK covers a total area of 329.16 hectares. A city called Nurkent was built from scratch. The population of the city is 1,200 people but is expected to reach 100,000 in the future. This Center offers a visa-free regime for citizens of China and foreign countries for up to 30 days, and businesses located on the territory of the Center are exempt from corporate tax, real estate tax, land tax and VAT.

The special economic zone "Khorgos-Eastern Gate" (KEG). Covering 4,591 hectares, KEG consists of a logistics zone, a dry port, and an industrial zone. The same tax preferences as for ICK are offered here. In 2014 an agreement was signed between Kazakhstan Temir Zholy (Kazakhstan's railway company) and Dubai DP World to manage KEG. The share of Dubai DP World in KEG's dry port is 51 percent, and COSCO,

a Chinese state-owned transportation company, owns 49 percent. So far, a total of US\$1.6 billion has been invested, of which 91 percent has come from private sources. Kazakhstan has allocated US\$115 million for infrastructure development. KEG is expected to handle 10 million tons of goods by 2020.

The port of Kuryk. It was built under Nurlı Zhol. In December 2016, a railway ferry complex with a capacity of 4 million tons was launched, and in 2017 construction of an automobile component of the ferry complex with a capacity of 2 million tons was started. Total cargo handling exceeds 6 million tons per year. In 2018, the Government of Kazakhstan and Dubai DP World signed an agreement on the purchase and management of the Aktau free economic zone. The share of Dubai DP World in the Aktau free economic zone is 49 percent.

Source: [DP World](#), [Kuryk Port](#), [MCPS Khorgos](#)

can increase the inflow of foreign direct investment to Central Asian countries by 12 percent.

4. Collaboration in the Field of Production

Capacities: A BRI Priority

The decline in oil exports to China (not only in the short term) and the expected production drop in oil fields with Chinese participation (as mentioned above), as well as Kazakhstan-led implementation of infrastructure projects, may have become the main starting points in determining the format of cooperation in the field of production capacities. Therefore, and despite the fact that Kazakhstan was the first country to which China offered cooperation in the production sphere, the negotiations have taken three years and as yet have to be finalized in the form of a Cooperation Plan in the field of production capacities for the next 5 years.

During the recent meeting of the two countries' heads of state on June 7, 2018, a Memorandum of Understanding was signed on the joint development of the China-Kazakhstan Cooperation Plan in the field of production capacities, which is to lay the foundation for bilateral cooperation in the field of production capacities 2019-2023⁴. In August 2015, Kazakhstan's Ministry for Investment and Development and the State Committee for Development and Reform of China signed a Framework Agreement on Strengthening Production Capacities and Investment Cooperation⁵. Based on this document, the China-Kazakhstan Coordination Committee for Production

Capacities and Investment Cooperation was established (Government of Kazakhstan 2016a).

Based on author's understanding, this to-be-adopted joint Plan will cover exclusively large projects, and the main form of financing is equity investment (as opposed to lending). There were official announcements that implementation of these so-called "51 projects" will attract US\$27 billion worth of investments to Kazakhstan. However, some projects are already in the implementation phase, like oil and gas sector projects, and projects in this field were initiated even before the BRI. Projects are in non-ferrous metallurgy, ferrous metallurgy, oil and gas (Box 2), chemicals, engineering, automobiles, and agriculture/agro-inputs and processing. For example, projects in the fields of non-ferrous and ferrous metals are aimed at strengthening capacity for processing aluminum and copper and producing seamless steel pipes; in the field of engineering, projects related to construction equipment, equipment for underground mining, ore processing and metallurgy are cited. All key sectors of Kazakhstan's economy and all regions of the country are covered.

From official documents consulted by the author, it appears that industrial development, digitalization and infrastructure will constitute the key directions of development, perhaps with a likely spillover or combination of activities between these priority areas.

The above directions of Kazakh-Sino cooperation give the impression of a well thought-out and sensible approach to bilateral cooperation and joint implementation of projects. If successfully implemented the projects will create opportunities for the development of a competitive agro-industrial complex, construction and engineering industry, and chemical and metallurgical sectors.

4. Based on Information from Ministry of investment of the Republic of Kazakhstan dated 1st of August 2018, No. 13-43600/20.

5. Based on Information from Ministry of investment of the Republic of Kazakhstan dated 1st of August 2018, No. 13-43600/20.

Box 2: Some Ongoing BRI Projects in the Oil and Gas Industry

China participates in practically all levels of the value chain of the oil industry: exploration, drilling, production, pipeline manufacturing and transmission operations, as well as oil refining and petrochemical production. A key event in 2017 was the completion of the reconstruction and modernization projects of two oil refineries (Pavlodar and Atyrau). In 2018, the modernization of the Shymkent oil refinery was completed. As a result, Kazakhstan's market is now supplied with domestic petroleum products: processing depth has increased on average from 63 to 83 percent, and production of class K4 and K5 fuels has started; these are positive signs of the Sino-Kazakhstan partnership.

In the gas sector, one equally notes positive developments with Chinese participation. With the commissioning

of additional capacities of the gas pipeline system in 2017, namely the "Beineu-Bozoy-Shymkent" gas pipeline and line "C" of the Kazakhstan-China gas pipeline, exporting gas to China became feasible. Thus in 2017, Kazakhstan began exporting gas to China at a volume of 1 billion cubic meters. Currently Kazakhstan is building capacity to increase gas supplies to China up to 5 billion cubic meters per year. Negotiations to increase gas supplies to 10 billion cubic meters per year are under way. Thus, for the first time in history, Kazakhstan has gained direct access to a major market for its hydro-carbon exports.

Source: Bukhina (2018), Enelane (2018)

Interestingly, all these directions have been repeatedly advocated by international experts as priority areas for economic diversification, including in the book *Kazakhstan 2050: toward a modern society for all* (Aitzhanova et al. 2014).

5. Financial Integration

Infrastructure project implementation modalities and cooperation in the sphere of production capacities determine the types of financial interaction. Below the author summarizes the various forms that have emerged in the course of Kazakhstan-China cooperation, which has intensified under the BRI.

First, joint investment funds: Since 2009, Kazakhstan and China have established joint investment funds to finance a number of major projects. For example, in 2009 CITIC Corporation and Samruk-Kazyna created the CITIC KAZYNA Investment Fund to jointly invest in projects outside of the oil sector. Capitalization was US\$200 million (KCM 2018a). In 2015, CITIC and Baiterek Holding (a parastatal financial holding) established the joint Kazakhstan Infrastructure Fund with a target capitalization of US\$600 million to finance manufacturing, infrastructure and agricultural investments (KCM 2018b). Another Kazakhstan-China Fund, Eurasian Nurlu (Bright) Investment Fund, was announced in July 2018 with a target of up to US\$, 500 million (Exclusive 2018). And finally, the Kazakhstan-China Fund for Industrial Cooperation Co. Ltd. was established with a capitalization of US\$2 billion⁶.

Second, China Development Bank and Export-Import Bank of China (CHEXIM) lending⁷: So far these loans are backed by Kazakhstan state guarantees; however, discussions are underway regarding the establishment of risk compensation funds as an alternative to state (i.e. sovereign) guarantees. These two policy banks finance not only infrastructure undertakings, but also projects in other sectors. For example, CHEXIM lent US\$1.1 billion to Kazmunaygas, Kazakhstan's main state-owned oil company, for additional capitalization of its subsidiary to invest in the production of aromatic hydrocarbons and deep oil refining (Enelane 2018).

Third, the constructive role of the Development Bank of Kazakhstan: The DBK is also active in the BRI, providing loans to Kazakhstani parastatals and private firms. As is general practice at development banks, DBK does not cover 100 percent of the financing needs. DBK has lent to

PetroKazakhstan for the modernization of the Shymkent refinery plant, which in turn hired a Chinese contractor (CPECC). The total cost is estimated at US\$2 billion (PetroKazakhstan 2017).

Fourth, Chinese investments in Kazakhstani financial institutions: The sale of 60 percent of Altyn Bank, a subsidiary of Kazakhstan's biggest bank, the Halyk Bank, was completed in April 2018. The buyers were China CITIC Bank (which bought a 50.1 percent stake) and China Shuangwei Investment Co. Ltd. (9.9 percent). For the Halyk Banking group, the partnership with China CITIC Bank offers the potential to access Chinese investors. Although now a minority shareholder of Altyn Bank, Halyk will be able to benefit from BRI projects by lending to Chinese companies in Kazakhstan. Furthermore, Altyn Bank will from now on provide direct settlement of Tenge-Yuan transactions (Vidyanova 2018). The Shanghai Stock Exchange and China's Silk Road Fund—specifically set up to finance BRI projects—are a combined 49 percent of the new Astana International Financial Center (AIFC)'s stock exchange that is expected to start operations by the end of 2018.

Finally, settlement in national currencies: In 2012, Kazakhstan and China signed a Yuan/Tenge swap agreement in the amount of US\$1 billion (CIS News 2011). In 2014, trading of Tenge/Yuan paired currencies started at the Kazakhstan Stock Exchange in Almaty. In parallel, the regional market of the Interbank Center for Foreign Exchange of China in Urumqi, the capital of China's Xinjiang province, offered a similar product (Ak Zhaik 2014).

Still, most long-term contracts are denominated in US dollars, reflecting the desire of counterparties to minimize currency risks. The trading volume on the stock exchange remains small (Figure 4), and 99 percent of all trades are made in US dollars. A number of obstacles weigh heavily: for instance, international payments in RMB can take up to seven days to be effected (t+7), which explains the low popularity of this currency. Kazakhstan's citizens continue to place their savings in US dollars and Tenge, and there is practically no demand for bank deposits in Yuan.

Despite the growing financial engagement of Kazakhstani organizations with Chinese financial institutions, the amount of debt outstanding remains relatively small relative to Kazakhstan's total external debt—less than 10 percent (Figure 5)—which in turn remains manageable in relation to Kazakhstan's GDP (9.5 percent of GDP).

6. Based on Information from Ministry of investment of the Republic of Kazakhstan dated 1st of August 2018, No. 13-43600/20.

7. Based on Information from Ministry of investment of the Republic of Kazakhstan dated 1st of August 2018, No. 13-43600/20.

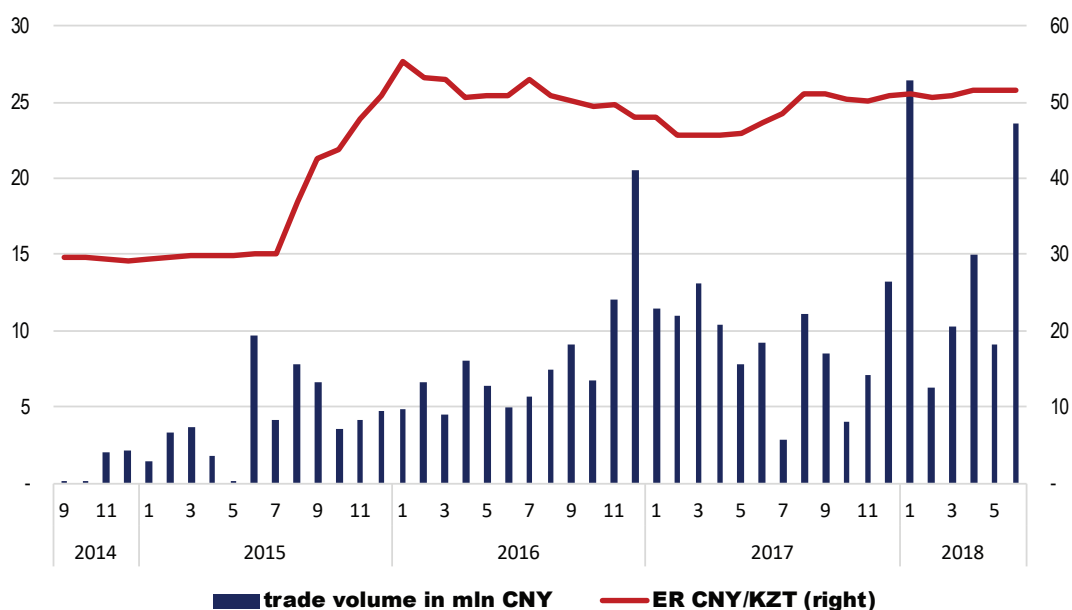
6. People-to-People Exchanges and Perceptions of China by Kazakhstanis

Kazakhstan and China established cultural ties at the very beginning of their bilateral cooperation and there has been a notable people-to-people exchange since that period, which is explained by the following reasons.

First of all, it is explained by China's geographic proximity, common border with Kazakhstan and large Kazakh diaspora living in China who support business ties with oralmans⁸ who migrated from China to Kazakhstan.

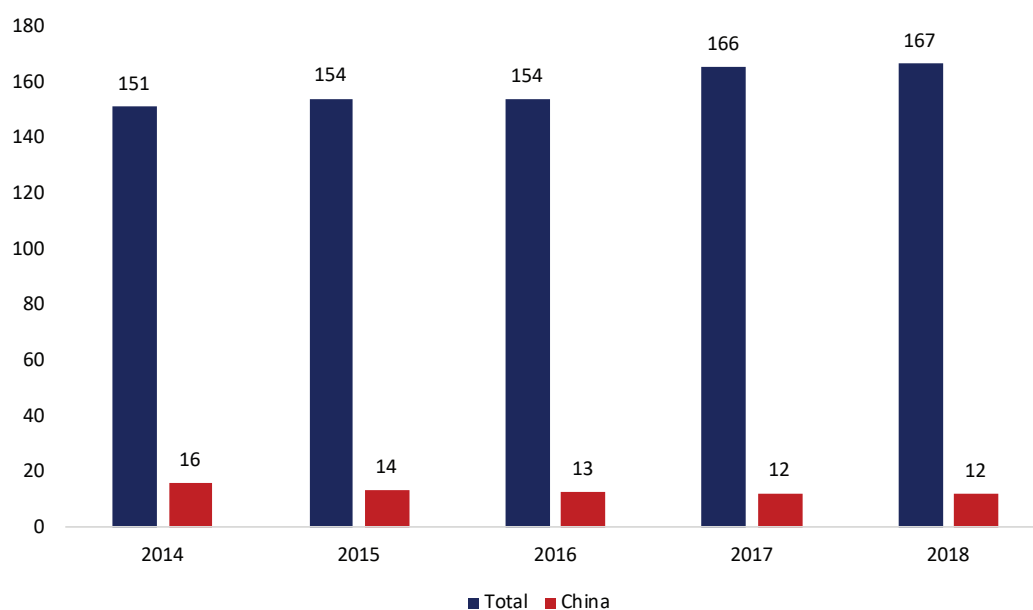
8. Oralman are ethnic Kazakh repatriates who migrate to Kazakhstan from neighboring countries (Uzbekistan, China, Turkmenistan, Russia, Kyr-

Figure 4: Trade in Yuan at the Kazakhstan Stock Exchange



Source: <https://www.kase.kz>

Figure 5: External Debt of Kazakhstan (US\$ billions)



Source: National Bank of Kazakhstan

Secondly, economic collaboration with China supports labor migration on both sides. According to Sadovskaya (2016), in Kazakhstan we can observe the following types of migration between Kazakhstan and China: travel authorized by official work permits, movement of businesspeople and retail traders, educational travel, and permanent stay migration related to the repatriation of ethnic Kazakhs from China. According to the Ministry of Interior of Kazakhstan, between 1995 and 2014, about 100 thousand ethnic Kazakhs migrated from China to Kazakhstan for permanent stay (Sadovskaya 2015).

Between 2015 and 2017 there were about 100,000 visas issued annually for citizens of China. However, it seems that two-thirds of visas are given to ethnic Kazakhs, while labor visas appear not to exceed 10,000 per year and business visas hover around 15,000-20,000 per year (Kiselyova 2017). China is an increasingly popular study destination for students from Kazakhstan. According to the Ministry of Education of China, in 2018 there were 17,600 students from Kazakhstan in China (according to Embassy of China in Kazakhstan, there were 14,000 in 2018) (Astakhov 2018).

A few Confucius Centers operate within Kazakhstan's national universities, but their activities are mostly limited to the organization of cultural events, translation works and Chinese language tests.

In terms of university-to-university collaboration, in 2017, Nazarbayev University joined two Chinese universities (Tsinghua and Peking) and 12 other top Asian universities as a founding member of the Asian Universities Alliance (AUA), a network created to conduct student, faculty and staff exchanges, support knowledge sharing and conduct joint research. The long-term objective is to put these top Asian universities on the map so that they can hold their own against better-known Western universities. Together with other recently established university networks such as the Silk Road Universities Alliance, these academic initiatives are among the most tangible BRI people-to-people initiatives.

7. Perceptions of China in Kazakhstan: Results of a Population Survey

Given the differences in mentality and long-held cultural and spiritual perceptions between Kazakhstani and Chinese people, but also against the background of the growing economic and political influence of China in the

region as well as globally, periodic social tensions flare up in Kazakhstan on the topic of China. For example, the land protests in May 2016 were started by unfounded rumors that the planned agricultural land lease reforms were meant to allow China to acquire long-term leaseholds that would never be returned.

In order to assess the perception of China by the population of Kazakhstan, NAC conducted in 2017 a one-time survey of 3,000 households across the country, including urban and rural respondents over 18 years of age from all regions (NAC 2017).

The survey results showed that Kazakhstan's society still has no clear vision vis-a-vis China. Citizens' opinions differ depending on their region of residence, nationality, age group, and income and education levels. At the same time, attitudes towards China are not formed based on personal impressions, but rather under the influence of information received from the media and social networks.

The results of the survey showed that China is represented primarily as an economic leader by a plurality (43.3 percent) of Kazakhstanis. Respondents with postgraduate education (62.9 percent) were more likely to represent China this way. 14.4 percent of respondents perceive China as an ancient civilization, while 9.3 percent as a communist power. Those who consider China as a role model (6.4 percent), an unstable state (5.1 percent), and those who find it difficult to give a definite answer (4.1 percent) remained in the minority. Every sixth resident of the country considers China as a threat to peace and security (17.3 percent) (Figure 6).

Speaking about economic relations with China, it should be noted that, according to 61.7 percent of Kazakhstanis, for the economic development of the country, it is most important to cooperate with Russia, and the primary importance of cooperation with China was noted by only 6.3 percent of citizens (Figure 7).

Despite the almost unanimous choice of Russia as the most important economic partner, many citizens (44 percent) consider friendship with China beneficial for Kazakhstan. And this perception increases with the level of education and income: among people with higher education this proportion is 45.6 percent; among the poor, this share was 37 percent, and among the more wealthy people (with incomes over 100 thousand tenge), 53.9 percent.

The perceptions of China by Kazakhs is inextricably linked with their attitudes toward the Chinese people (Figure 8). The survey results showed that more than half of the respondents indicated an indifferent position (52.0

gyz Republic), as well as a number of other Asian countries (Mongolia, Iran, Afghanistan, Pakistan, etc.). According to official data, over 25 years (from 1991 as of January 1, 2016), 957,764 oralmans arrived in Kazakhstan.

percent). Every sixth referred to the Chinese negatively (16.5 percent), while 14.7 percent expressed interest in them. The remaining respondents expressed a more emotional attitude: 8.7 percent feel fear of the Chinese, and 8.1 percent admire them.

An interesting fact is that the negative attitude towards the Chinese in general is not based on personal negative experiences of communication with them. Only 6.5 percent of respondents had had negative experiences with representatives of China. The majority (54.9 percent) explain

Figure 6: Survey Results for the Question “In your opinion, what is China like primarily?”

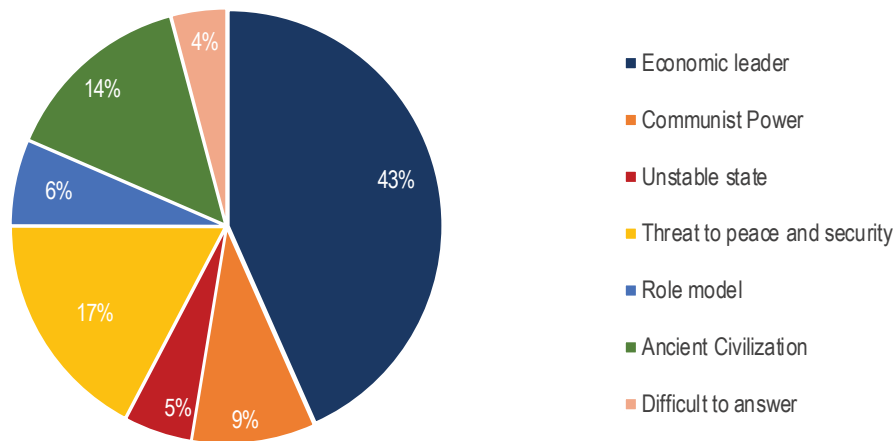


Figure 7: Distribution of Countries by Importance of Cooperation with Kazakhstan (%)

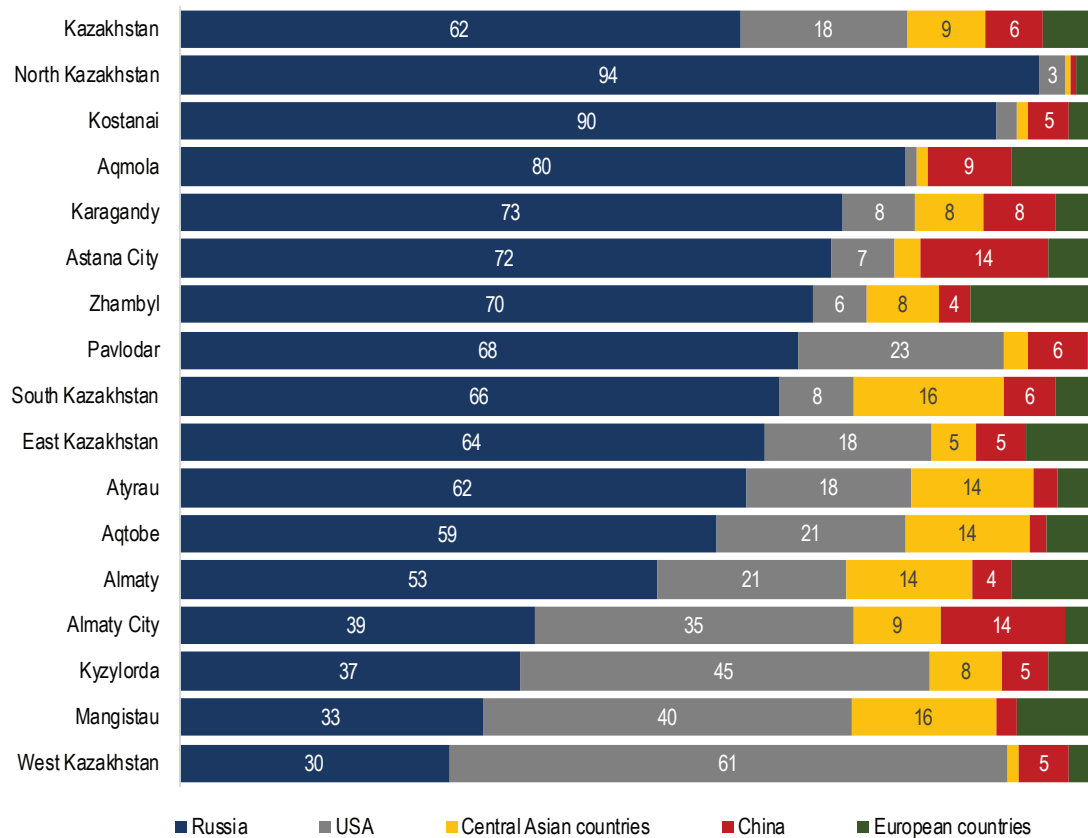
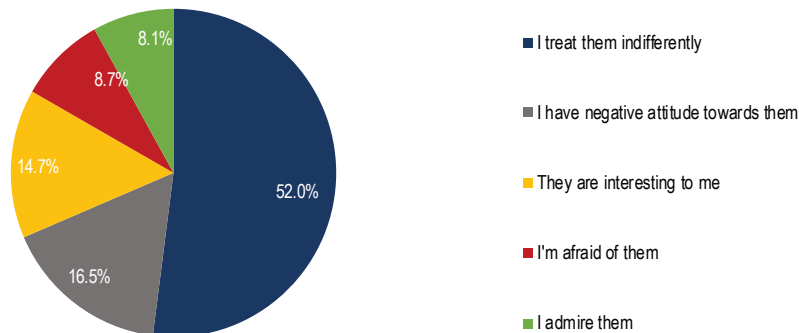


Figure 8: “How do you personally feel about Chinese people?”


their dissatisfaction with the poor quality of goods and products supplied from China. Almost a third (28.8 percent) respondents pointed out the strangeness and lack of understanding of Chinese people. In general, respondents who had experience communicating with them much more often indicated a positive attitude towards the Chinese who work and/or live in Kazakhstan.

A clear trend among the young generation of Kazakhstan is emerging: in comparison with the older generation they show a more positive attitude toward China, showing interest in its people and willingness to conduct business with them. Visits to China (actual or planned) are more often mentioned by youth (24.4 percent), decreasing to 8.5 percent among the older generations. This indicates growing interest in and popularity of China as a destination.

So, overall, one can conclude that perceptions of China are rapidly shifting among Kazakhstan's younger generation, and there in particular among the educated urban population.

8. Conclusion

Kazakhstan is a key member of the Belt and Road Initiative; some refer to Kazakhstan jokingly as the “buckle in the belt.” The BRI presents an opportunity for the country to overcome geographic restrictions, diversify trade, and provide an additional boost to economic growth through closer integration with the global economy within the groundwork of this undertaking.

The author believes many factors facilitate the pursuit of this integration goal: the Astana International Financial Center with its introduction of English law to adjudicate all commercial transactions; the introduction of the English

language in schools at the primary level; the transition to the Latin alphabet; and infrastructure investments linking Kazakhstan with China, Europe, and the Middle East. In the event of effective implementation, the above initiatives can become the key drivers of economic growth for Kazakhstan.

At the same time, it is rather difficult to credit only the Belt and Road Initiative, given that Kazakhstan's economic cooperation with China has been developing at an accelerated pace since the beginning of 2000. The Initiative was announced in 2013, but many projects currently announced under the umbrella of the BRI in Kazakhstan started before then. Information about projects is limited. One cannot but agree with the report of Jonathan Hillman (2018) that the projects are non-transparent. In Kazakhstan, when contacting several institutions, we were faced with difficulties in gathering information even at the top level. Questions also arose as to which projects were completed and which were not completed. The same issue was raised by experts from Kazakhstan and the World Bank. This lack of transparency and hence of information does not allow for assessment of the impact of the Initiative on the economy of Kazakhstan.

Perhaps the future of this Initiative is also in question (Yusuf et al. 2018). The entire project was built on the expected financing of projects by Chinese state-owned banks. However, due to the tightening of credit conditions in China and the low profitability of infrastructure projects, the interest of Chinese banks in the BRI seems to be decreasing. Already in the first quarter of 2018, the volume of investments in 55 countries in the framework of the Initiative has decreased by 15 percent. Another issue that

negatively affects the development of the Initiative is the format of resolving debt crises related to Chinese loans on state guarantees. Over the past few years, China, in return for debt, has taken strategic sites from several states. For example, in 2011, China wrote off a debt to Tajikistan in exchange for a territory that had been the subject of a multi-year dispute; in 2017, China gained control of the port of Hambantota in Sri Lanka; in the future, China could get the port of Gwadar in Pakistan. Kazakhstan-China relations seem to be developing on a different approach.

As can be seen from the above sections, cooperation between Kazakhstan and China within the framework of the Belt and Road Initiative is only starting, so one might be better off to study the BRI over the course of 2-3 years. On the other hand, at the moment, one should note that the Government of Kazakhstan rather carefully forms its policy of economic interaction with China, choosing those projects that are important for the country, and in most cases trying to attract own funds to the projects or involving international financial organizations or third-country parties like Dubai's DP World. Importantly, in Kazakhstan the government developed its own infrastructure and connectivity program and subsequently invited China to complement and participate as needed; other BRI activities have been worked out at a deliberate pace to ensure that they support Kazakhstan's economic development.

In sum, the author believes that in some respects, Kazakhstan can be viewed as a model for other developing countries and emerging markets as they develop their collaboration with China at this stage of implementation, bearing in mind that only five years have passed since the announcement of the BRI.

In general, it should be noted that the Initiative lacks any detailed information on distribution of projects across all countries, and there is no standardized approach. Each country case is different from another. In this sense, I am reminded of a comment by a China expert that the BRI is more a marketing "idea" supported primarily by the academic world. Even in China itself, there is no common understanding of this Initiative, and that's "the China way."

As a next step, one should conduct value chain analysis of all production capacity projects in Kazakhstan to see if they are facilitating the country's integration into global value chains. Another area of research interest might be in understanding the potential of the Astana International Financial Center in supporting financial integration along the Belt and Road. Lastly, I believe that there is a need to develop a framework for comparative analysis among

countries with positive experiences, for example Kazakhstan vs. Indonesia.

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Annex: “51 Projects”

51 projects are identified in the following spheres:

Manufacturing

- Production of construction materials, cement, glass, etc.
- Ferrous metallurgy
- Non-ferrous metallurgy
- Oil and gas refining
- Chemicals
- Mechanical engineering
- Power generation
- Road, railway and air infrastructure construction
- Textiles, wools, etc.
- Agricultural processing
- Food manufacturing
- Fast-moving consumer goods

Services

- Transport logistics
- Tourism

Figure A1: Institutional Arrangements



Figure A2: Implemented Projects

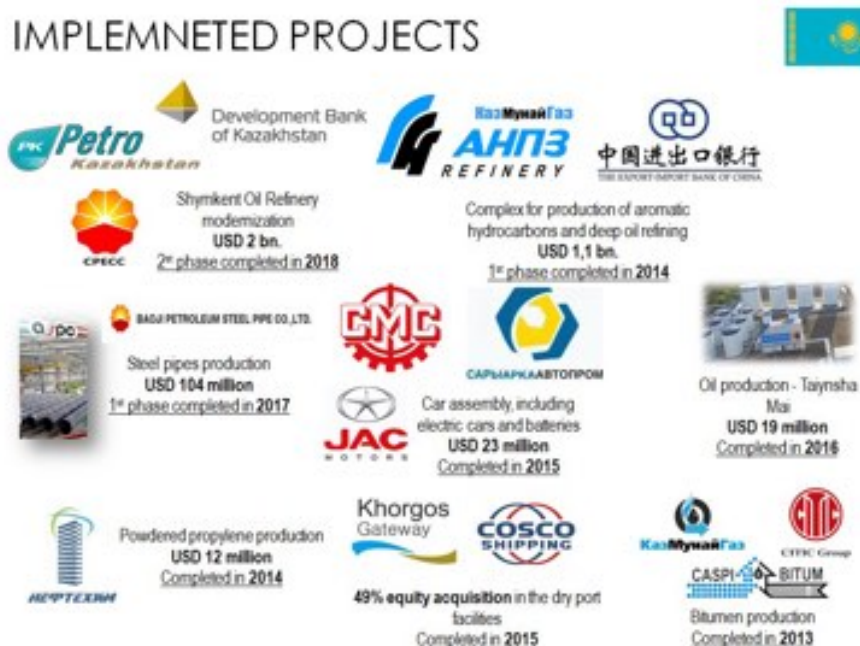
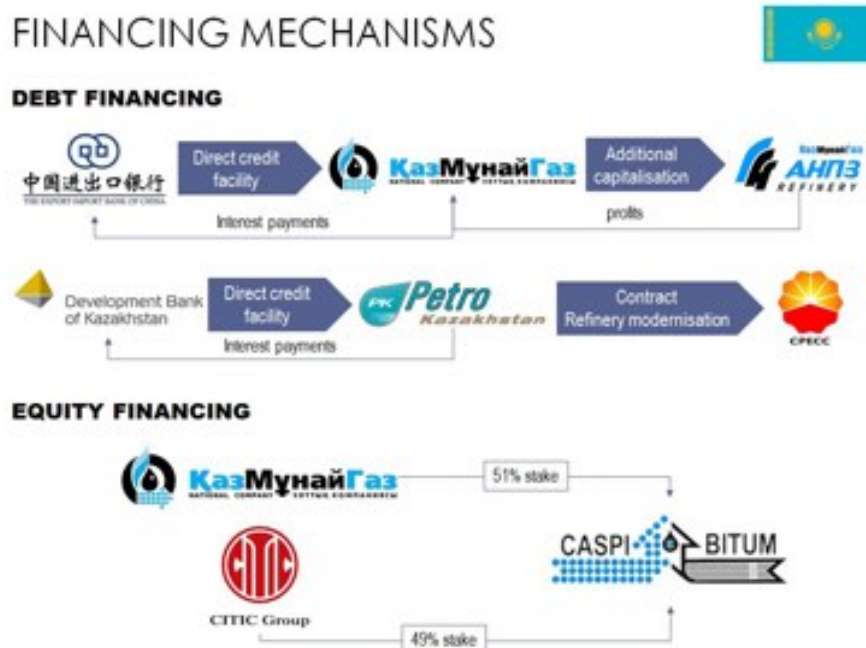


Figure A3: Financing Mechanisms



The Kyrgyz Republic and the Belt and Road Initiative

Roman Mogilevskii

1. Introduction

The Kyrgyz Republic is one of western neighbors of the People's Republic of China (PRC). As such, it already has strong ties with the Chinese economy and could become one the major beneficiaries of the Chinese Belt and Road Initiative (BRI). This note provides an analysis of the current state of the economic relationships between China and the Kyrgyz Republic and discusses the potential of these relations' further development in the BRI context. Economic relationships under consideration include trade in goods and services, foreign direct investment (FDI), major infrastructure projects implemented in the Kyrgyz Republic with support from China and other activities. The paper covers the period from 2006 to 2018 in order to trace the evolution of Chinese-Kyrgyz economic relationships from a relatively low and fragmented level to the current situation, in which China is one of the key (if not the largest) economic partners of the Kyrgyz Republic.

In this paper, all Chinese-Kyrgyz economic relationships are considered to be a part of the BRI agenda, whether or not these activities have been explicitly labeled as 'BRI' projects. Implementation of some Chinese projects in the Kyrgyz Republic started before the BRI had been officially announced by the leadership of China in 2013. Some other projects are implemented by the Chinese private sector and it is not known whether or not these companies receive direct support from the Government of the PRC in the framework of the BRI. Still, all these activities and projects are considered here as direct contributions to the BRI's goal of improving connectivity and enhancing hard and soft infrastructure to boost economic and human ties in the big region of Eurasia and beyond it.

The paper is structured in the following way. Section 2 discusses key forms of cooperation between China and the Kyrgyz Republic which are broadly attributable to the BRI agenda. These include implementation of large infrastructure projects, Chinese FDI projects in the Kyrgyz Republic, and development of trade relations between these two countries. Section 3 provides an assessment of achieved

cooperation results so far, including BRI-related changes in production, employment, foreign trade, government external debt, governance, and regional cooperation. Section 4 provides an overview of potential future activities in the BRI framework and their impact on social and economic development in the Kyrgyz Republic. Section 5 formulates some recommendations to the BRI process stakeholders, and Section 6 summarizes research questions which seem to deserve more detailed study in the future.

2. Key BRI-related Ongoing Activities in the Kyrgyz Republic

2.1. Public Infrastructure Projects

In recent years the government of China has supported the implementation of several major infrastructure projects in the Kyrgyz Republic. Table 1 provides a summary of the most important infrastructure projects financed by the government of China and implemented by Chinese companies. Almost all projects in this list have been financed through concessional loans. The total amount of loans in the table is US\$2.1 billion; if one adds to this amount the grants and the costs of "resources in exchange for investment" projects, the total cost of infrastructure projects financed by China in the Kyrgyz Republic go as high as US\$2.2 billion. Conditions of the loans have been somewhat changing with time towards longer loan repayment and grace periods and lower interest rates. Funding for the last two (smaller) projects listed in Table 1 has been provided in the form of grants. These projects concentrate on automobile road rehabilitation (Figure 1), energy system rehabilitation/development and urban development.

The **road projects**, with a total cost of US\$1,128 million, aim to improve connectivity inside the Kyrgyz Republic in the North-South and East-West directions. Simultaneously, these projects are parts of the so-called CAREC corridors, which have been designed to improve transportation links in Central Asia and connect the region with China, South and West Asia, and Europe. The Bishkek-Naryn-Torugart

Figure 1: BRI-related Automobile Road Projects in the Kyrgyz Republic

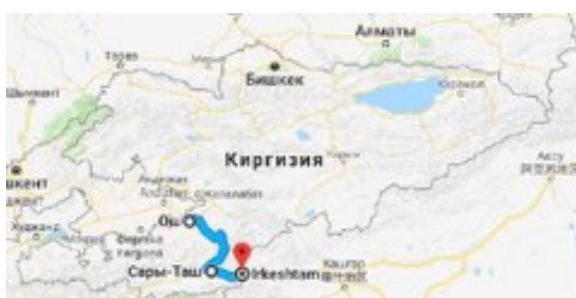
(a) Bishkek-Naryn-Torugart (blue line)



(b) Alternative North-South Road (red line)



(c) Osh-Sarytash-Irkeshtam (blue line)



(d) Osh-Batken-Isfana (pink line)

Source: <http://piumotc.kg/en/main/>, Google Maps

road is a part of the CAREC Corridor 1c, the alternative North-South road is in the Corridors 1 and 3 Connector Road, and the Osh-Sarytash-Irkeshtam and Osh-Batken-Isfana roads are part of Corridor 2. The roads are considered to have a strategic importance for the country. Bishkek-Naryn-Torugart and Osh-Sarytash-Irkeshtam are the main roads connecting the Kyrgyz Republic with China; the alternative North-South road is to become the second road connecting the northern and southern parts of the Kyrgyz Republic, which are separated by mountain ridges; the Osh-Batken-Isfana road is built for the purpose of bypassing Uzbek and Tajik enclaves and to allow for uninterrupted traffic between the western Batken oblast (province) and other parts of the Kyrgyz Republic.¹

The **energy projects**, with a total cost of US\$984 million, include construction of the Datka-Kemin strategic electricity transmission line and Datka substation and the associated project to modernize electricity transmission lines in the South of the Kyrgyz Republic, which aim to (a) ensure the energy independence of the Kyrgyz Republic from the single energy system of Central Asia inherited from

Soviet times, and (b) become a part of the CASA-1000 megaproject, allowing energy supplies from the Kyrgyz Republic and Tajikistan to power the countries of South Asia. Another energy project—Bishkek Heat and Power Plant (HPP)—has been designed to improve electricity and heat supply in Bishkek, the capital of the Kyrgyz Republic. The HPP is based on usage of coal, so other donors might hesitate to support such a “non-green” project.

In addition to these loans for energy projects, China is also going to build a gas pipeline in the south of the Kyrgyz Republic, which is a part of line D of the Central Asia-China gas pipeline network. The Kyrgyz Republic would play only a transit role, with no technical possibility of receiving gas from or supplying gas to the pipeline. The government of the Kyrgyz Republic is not going to have a stake in the equity of the pipeline, so the pipeline is an FDI project of China in the Kyrgyz Republic. Work on this project in the Kyrgyz Republic is planned to begin in 2019.

Recently, the government of China has expanded its infrastructure activities in the Kyrgyz Republic to **urban development** by providing two grants worth of US\$121 million to rehabilitate and develop the street network in Bishkek.

1. Utilization of existing roads crossing territories of these enclaves is not always possible or easy (see e.g. <https://www.economist.com/banyan/2014/04/02/the-post-imperial-chessboard>).

All these infrastructure projects have been implemented in case of energy projects), which use almost exclusively by Chinese companies (e.g. China Road and Bridge Corporation [CRBC] in case of road projects; TBEA Co. Ltd.

Table 1: Key Infrastructure Projects in the Kyrgyz Republic Supported by the Government of China

| | Year of agreement | Amount | | Terms | | | | Notes |
|---|-------------------|-------------|----------|--|---------------------|---------------|-------------------------------|--|
| | | US\$ mil. | CNY mil. | Repayment period, years | Grace period, years | Interest rate | Commission and management fee | |
| Rehabilitation of Osh-Sary-tash-Irkeshtam road (section from 190 to 240 km) | 2008 | 25.3 | | This project was based on the “resources in exchange for investment” scheme – Chinese party (China Development Bank and a consortium of companies from China) fully financed the road rehabilitation; in exchange, the Kyrgyz government allowed Chinese company “Full Gold Mining” to develop the gold deposit Ishtamberdy. | | | | Other parts of this road financed by multilateral financial institutions |
| Rehabilitation of Osh-Sary-tash-Irkeshtam road (section from 123 to 190 km) | 2009 | 75.3 | | 20 | 5 | 2% | 0.50% | |
| Rehabilitation of Bishkek-Naryn-Torugart road (section from 9 to 272 km) | 2009 | 200 | | 20 | 5 | 2% | 0.50% | Other parts financed by multilateral financial institutions |
| Modernization of electricity transmission lines in the South of the Kyrgyz Republic | 2011 | 208 | | 20 | 7 | 2% | 0.50% | |
| Construction of 500 kV Datka-Kemin electricity transmission line and 500 kV Datka substation | 2012 | 389.8 | | 20 | 9 | 2% | 0.50% | Part of regional CASA-1000 project |
| Modernization of Heat and Power Plant in Bishkek city | 2013 | 386 | | 20 | 11 | 2% | 0.43% | |
| Alternative North-South road (sections Kazarman-Jalal-Abad and Balykchi-Aral) | 2013 | 400 | | 20 | 11 | 2% | 0.43% | |
| Gas pipeline the Kyrgyz Republic-China | 2013 | 1,000-1,200 | | FDI, no Kyrgyz government equity participation | | | | Segment of the 4th ('D') Central Asia – China pipeline |
| Rehabilitation of Osh-Batken-Isfana road (sections from 220 to 232 km and from 248 to 360 km) and Bishkek-Balykchi road (section from 147 to 172 km) | 2015 | 129.8 | | 20 | 11 | 2% | 0.50% | Other parts financed by multilateral financial institutions |
| Alternative North-South road (part Aral-Kazarman) | 2015 | 185.3 | | 20 | 11 | 2% | 0.36% | Approx. 62% of total costs of the project |
| | 2015 | * | 697.6 | 25 | 11 | 1.50% | 0.36% | Approx. 38% of total costs of the project |
| Development of street network in Bishkek city (phase 1) | 2015 | ** | 489.5 | | Grant | | | |
| Development of street network in Bishkek city (phase 2) | 2017 | *** | 286.0 | | Grant | | | |

Source: China-Kyrgyz Republic intergovernmental agreements (as provided in the legislation of the Kyrgyz Republic available at Toktom legal information portal)

* Equivalent to US\$112.0 million at 2015 CNY/US\$ average exchange rate of 6.227 (WDI)

** Equivalent to US\$78.6 million

*** Equivalent to US\$42.3 million at 2017 CNY/US\$ average exchange rate of 6.759 (WDI)

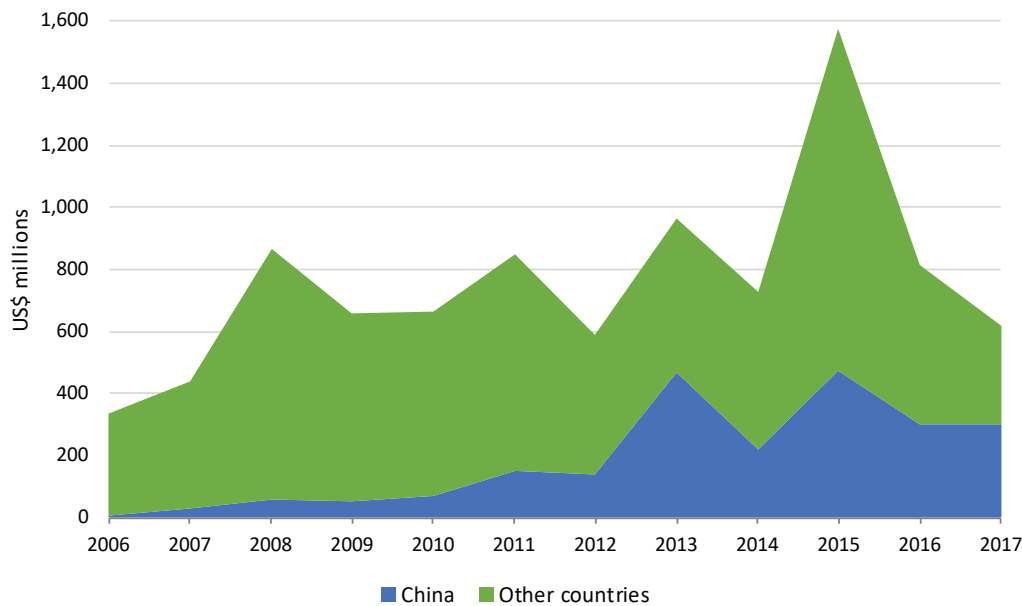
Chinese labor. Most machinery, equipment and materials have also been imported from China.

2.2. Foreign Direct Investment

Since 2012, China has become the largest source of foreign direct investment into the economy of the Kyrgyz

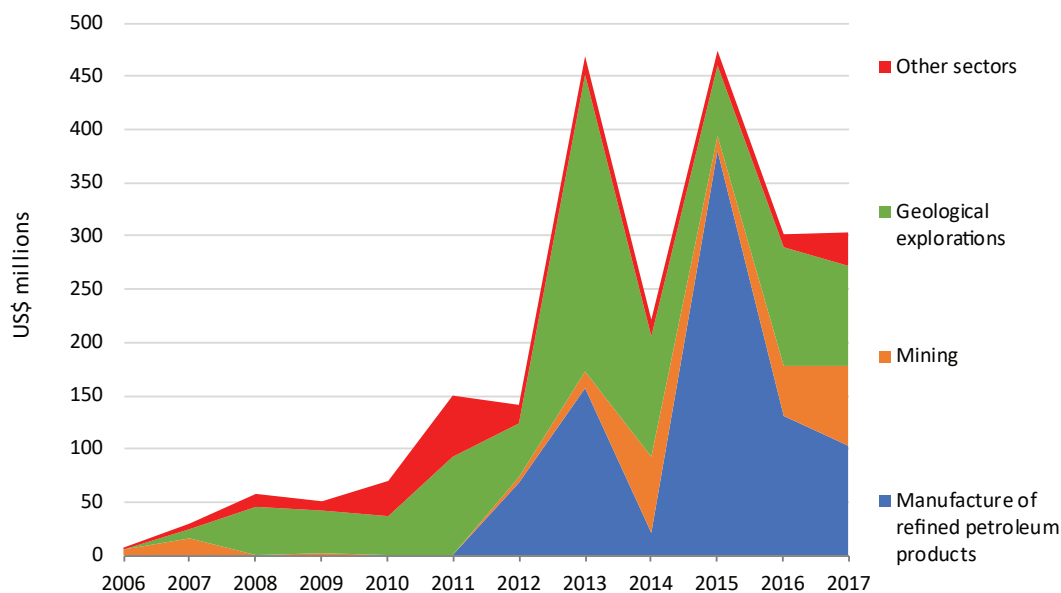
Republic (Figure 2); for 2006-2017 the cumulative gross Chinese FDI inflow was equal to US\$2.3 billion. For this period, Chinese FDI constituted 25-50 percent of total FDI to the Kyrgyz Republic, equivalent to 2-7 percent of the country's GDP.

Figure 2: Gross Inflows of FDI from China and Other Countries



Source: National Statistical Committee of the Kyrgyz Republic

Figure 3: Chinese FDI by Sector



Source: National Statistical Committee of the Kyrgyz Republic

Key Chinese FDI sectors are geological exploration, mining and production of refined petroleum products (Figure 3). Mining-related FDI (geological exploration and mining) concentrate on the development of gold deposits in the Kyrgyz Republic. Chinese companies operate some 10 medium-sized mines producing gold-copper concentrate, which is exported for refining in China. According to official statistics, there are not any major Chinese agricultural investment projects in the Kyrgyz Republic, though there is a plan announced by the governments of China and the Kyrgyz Republic to build the Iskra Asia agro-industrial park near Bishkek to produce meat, fish and animal feed both for the domestic market and for export to China.

At least some of the Chinese investors are state-owned enterprises (e.g. gold producer Full Gold Mining was established by the state corporation Linbao Gold); they operate FDI projects as foreign enterprises or as joint ventures with the Kyrgyz state (e.g. state-owned gold producer Kyrgyzaltyn) and private companies with majority shares owned by the Chinese party.

Production of refined petroleum products. Chinese companies have built two oil refineries in the northern part of the Kyrgyz Republic near Bishkek; one of these enterprises (Zhongda China Petrol Company) is the largest enterprise in this sector in the Kyrgyz Republic. There are no oil deposits nearby (either in the Kyrgyz Republic or in neighboring countries) to supply these refineries through a pipeline. One rather scarce source of raw materials is domestic crude oil produced in the south of the Kyrgyz Republic (railroad connection to the refineries is possible only through the territories of Uzbekistan and Kazakhstan). Another (more important) source of raw materials is imports of crude oil and semi-processed oil products (black oil) from Kazakhstan. These raw materials also come to the refineries by rail. Due to relatively high raw material and transportation costs, the refineries seem to lack competitive advantages on the domestic market in comparison to Russian oil products imported to the Kyrgyz Republic on beneficial terms (in accordance with the bilateral Russian-Kyrgyz intergovernmental agreement, no export duty is charged on Russian oil products exported to the Kyrgyz Republic). As a result, the refineries are reported to operate below one-third² of their capacity and mostly export their products to Tajikistan and Afghanistan, where prices for oil products are higher than in the Kyrgyz Republic. The refineries seem to face the necessity of additional investments, as in the nearest future the Kyrgyz Republic should enact

new technical regulations for oil products adopted by the Eurasian Economic Union (EAEU). Based on environmental considerations, these regulations require the cessation of production of gasoline and diesel fuel of Euro-2, Euro-3, and Euro-4 types for the EAEU market by 2019; by 2021, exports of these low-quality oil products should also be stopped. This directly affects the Chinese refineries as they specifically produce Euro-2, Euro-3, and Euro-4 type fuels. So, to continue their operations, these enterprises should upgrade their products in the next couple of years to at least Euro-5 level.

Chinese FDI in other sectors of the Kyrgyz economy (e.g. retail trade, construction materials production, food processing) are relatively minor. In 2009, the Export-Import Bank of China (CHEXIM) financed the construction of a large cement plant in the southern Kyrgyz Republic. Later, however, this plant was sold to Kazakh investors.

3. Effects of BRI Projects

3.1. Output, Employment, Government Revenue, Exports, and Imports

Assessment of the contribution of BRI-related infrastructure and FDI projects to the economy of the Kyrgyz Republic is complicated by the fact that no direct disaggregated data on economic activities of Chinese enterprises exists. So, only some (rather rough) estimates seem to be possible.

For 2011-2017—the period of the most active implementation of Chinese infrastructure and FDI projects in the Kyrgyz Republic—the total amount of money committed to these projects was equal to US\$4.1 billion (US\$2.2 billion in infrastructure projects and another US\$1.9 billion in FDI projects, see Section 2). Some of this money may not be disbursed yet, but about 80-90 percent of this amount has been invested already in the Kyrgyz Republic. This inflow of resources is equivalent to some 7-8 percent of GDP per annum.³ This is a very significant contribution to the Kyrgyz economy. However, the contribution to aggregate demand was much smaller, as most of these resources were spent on imports of goods and services from China. So, the main impact on the Kyrgyz GDP should be through the accumulated stock of fixed capital (improved roads, electricity transmission lines and substations, oil refineries, mines, etc.). Some of these projects are still under construction; other projects have been completed recently, so one could not expect any major impact on the economy's

2. 2017 estimate based on information from the State Committee on Industry, Energy and Subsoils of the Kyrgyz Republic.

3. Annual GDP of the Kyrgyz Republic in 2011-2017 was between US\$6.2 billion and US\$7.5 billion (at current exchange rate).

production capacity. A comparison of the average annual GDP growth rates in 2011-2017 and in 2000-2010 shows some increase, from 4.2 percent per annum (2000-2010) to 4.8 percent per annum (2011-2017). Of course, there were other factors contributing to somewhat elevated GDP growth in the latest period of time, including (i) a historically high level of remittance inflow to the Kyrgyz Republic (about or above 30 percent of GDP per annum); (ii) increased confidence of domestic and foreign consumers and investors after political stabilization following the 2010 revolution; and (iii) an inflow of resources associated with the accession of the Kyrgyz Republic to the EAEU (e.g. establishment of the Russian-Kyrgyz Development Fund managing US\$500 million provided as FDI from Russia). In most sectors affected by Chinese investments, an increase in the share of gross value added in GDP has been observed between 2010 and 2016 (Table 2).

The contribution of these projects to *employment* in the country does not seem to be significant. As mentioned above, the infrastructure projects are implemented by Chinese companies using a very limited number of the Kyrgyz workers. There are 10-15 enterprises with considerable Chinese FDI.⁴ Each of these enterprises employs between 100 and 500 Kyrgyz workers (and a comparable number of employees from China), so the total number of new jobs for Kyrgyz workers should be about several thousand, or 0.1-0.3 percent of total employment in the country (2.4 million people in 2016).

Regarding the contribution of enterprises with Chinese participation to the government budget of the Kyrgyz Republic, enterprise-level data are available from the Ministry of Finance of the Kyrgyz Republic. According to these data, in 2017 these enterprises paid KGS3.66 billion in taxes (equivalent of US\$53.2 million at 2017 average exchange rate of 68.87 KGS/USD). This amount made up 2.5 percent of total state budget⁵ revenue in that year. Of

this total, two-thirds had been paid by one enterprise—the oil refinery Zhongda. All mining enterprises with Chinese participation paid KGS1.18 billion (US\$17.1 million). Available estimates indicate that the tax burden for gold mines in the Kyrgyz Republic (except Kumtor, the largest mine in the Kyrgyz Republic, operated by Canadian company) is much lighter than in other countries of the world (Manley 2018, Mogilevskii et al. 2015).

The BRI's effect on the *foreign trade* of the Kyrgyz Republic seems to be two-pronged: the effects on bilateral trade between the Kyrgyz Republic and China and the effects on the Kyrgyz Republic's trade with third countries. Due to major discrepancies in bilateral trade statistics, it makes sense to consider the data on this trade from both Kyrgyz and Chinese sources (Figure 4).

The main component of this trade—import and re-export⁶ of Chinese light industry products (textiles, footwear etc.)—started in 1990s and achieved its peak in 2008. This component of trade is run mostly by individuals and SMEs and does not seem to be a part of the BRI agenda. It, however, could be affected by the improvements in main transport arteries serving this trade: the Bishkek-Naryn-Torugart and Osh-Sarytash-Irkeshtam roads. Rehabilitation of these roads was mostly completed in the early/mid-2010s. The Chinese data⁷ on the weight of light industry products exported to the Kyrgyz Republic does not show any ascending trend; on the contrary, the average annual weight of light industry products in 2016-2017 was reported to be 16 percent lower than in 2011-2013, according to UN Comtrade. Of course, the weight and value of this trade flow depend not only/not so much on the transportation costs on the Kyrgyz part of the route, but also on many other factors, especially the demand for Chinese textiles and footwear in Russian and Central Asian markets. Anyway, there seems to be no evidence to support the claim that the rehabilitation of the roads

4. According to National Statistical Committee of the Kyrgyz Republic, 567 enterprises with full or partial participation of citizens of China in equity had been registered in 2016. However, most of these enterprises were either small or idle.

5. State budget consolidates the republican (central government) and local government budgets.

6. Since the early 2000s, the Kyrgyz Republic has been known to be a hub of re-export trade in Chinese consumer goods for a large region encompassing Central Asia and large part of Russia; see details in Kaminski and Mitra (2011) and Mogilevskii (2012).

7. The Kyrgyz data on this component of bilateral trade are known to be heavily downward-biased (see the paper on re-exports mentioned in the previous footnote).

Table 2: Growth of Key Sectors Receiving Chinese Investments

| Sector | Gross value added, % of GDP | | |
|--|-----------------------------|------|--------------------------------|
| | 2010 | 2016 | Increase between 2010 and 2016 |
| Extraction of metal ores | 0.01 | 0.39 | 0.38 |
| Production of oil products and other chemicals | 0.47 | 0.75 | 0.28 |
| Production, transmission and distribution of electricity | 1.56 | 1.84 | 0.28 |
| Transport and logistics | 4.73 | 3.92 | -0.81 |

Source: National Statistical Committee of the Kyrgyz Republic

connecting China and the Kyrgyz Republic has positively contributed to this trade in light industry products.

The components of bilateral trade which seem to be directly associated with BRI-related projects are exports of gold concentrate from the Kyrgyz Republic to China and imports of machinery and equipment for infrastructure and FDI projects from China to the Kyrgyz Republic. The exports of gold concentrate (Figures 4a and 4b) have just recently started; in 2016-2017, these were on the level of US\$30-40 million per annum, which is about 2 percent of total Kyrgyz exports of goods. Imports of machinery and equipment (Figures 4c and 4d) stayed at the rather high level of US\$300-500 million⁸ for 2011-2017. This is equivalent to 25-50 percent of total imports of machinery and equipment or 6-10 percent of total imports of goods to the Kyrgyz Republic.

The only traceable effect of BRI projects on trade with third countries seems to be the emerging exports of oil products to Tajikistan and Afghanistan from Zhongda oil refinery (see section 2.2). In 2015-2017, these exports fluctuated in the range of US\$2-16 million, or 0.2-1.1 percent of total merchandise exports from the Kyrgyz Republic.

The trade in services between the Kyrgyz Republic and China is rather small (Figure 5). Exports and imports of services to China make up 4.7 percent of total exports and 7.9 percent of total imports of services of the Kyrgyz Republic, respectively. Key tradeable (in both directions) services include tourism and construction inside the Kyrgyz Republic.⁹ the Kyrgyz Republic also imports some automobile and air transport and logistics services from Chinese providers. Construction services and, possibly, some transport services could be directly attributed to the BRI-related projects mentioned above.

3.2. Accumulation of Government External Debt

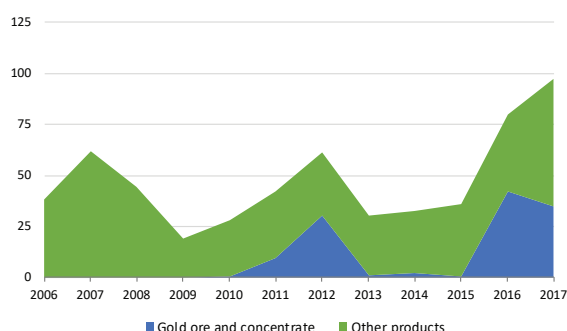
Massive inflows of resources for public infrastructure projects resulted in fast growth of the Kyrgyz government's debt to CHEXIM (Figure 6). In less than ten years it increased from US\$9 million (2008) to US\$1,701 million (2017). As of end-2017, China was the main creditor of the government of the Kyrgyz Republic; the debt to CHEXIM made 42 percent of total government external debt, or 24 percent of GDP.

8. This figure even reaches US\$650 million for some years, according to Chinese data.

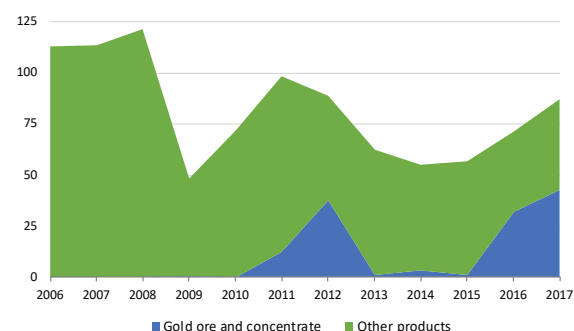
9. Kyrgyz exports of these types of services cover the services of Kyrgyz subcontractors to Chinese contractors of infrastructure and FDI projects.

Figure 4: Trade in Goods between the Kyrgyz Republic and China (US\$ millions)

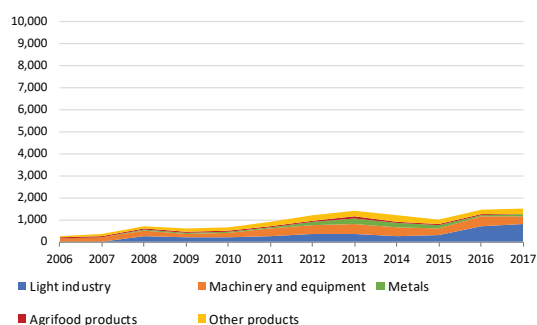
(a) Exports from the Kyrgyz Republic to China, Kyrgyz data, fob prices



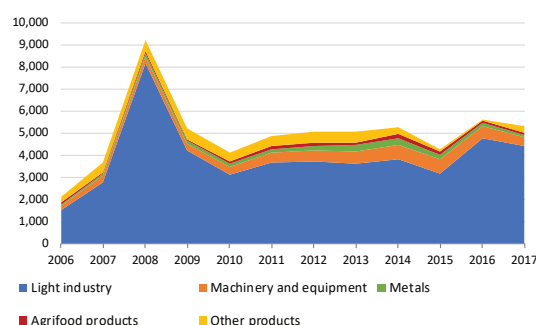
(b) Imports from the Kyrgyz Republic to China, Chinese data, cif prices



(c) Imports to the Kyrgyz Republic from China, Kyrgyz data, cif prices



(d) Exports to the Kyrgyz Republic from China, Chinese data, fob prices



Source: UN Comtrade, State Customs Service of the Kyrgyz Republic

As follows from the data provided in Table 1, all infrastructure loans provided by the government of China are concessional ones with effective interest rates of 1.86-2.5 percent, repayment periods of 20-25 years and grace periods of 5-11 years. Therefore, the debt service burden may start to be felt only after the expiration of the grace periods for most loans received so far (sometime in the 2020s).

According to the joint assessment of the IMF (2018) and IDA, the Kyrgyz Republic remains at moderate risk of debt distress, but the debt situation is still vulnerable to large external shocks.

3.3. Regional Cooperation

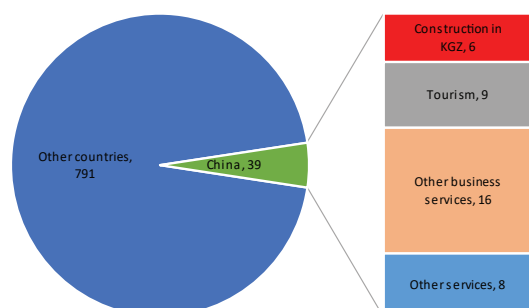
The implementation of BRI-related projects takes place against the background of many ongoing regional economic cooperation initiatives, including the Central Asia Regional Economic Cooperation (CAREC) Program and the Eurasian Economic Union (EAEU).

Among other things, CAREC coordinates multiple transport and energy projects in Central Asia. It seems that Chinese infrastructure development projects are well

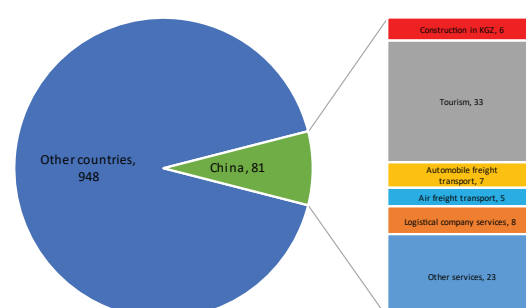
integrated into the CAREC agenda. All roads rehabilitated with Chinese concessional loans are parts of CAREC corridors (see section 2.1). Typically, Chinese loans cover some parts of the rehabilitated roads while other parts are supported by other development partners (i.e. the Asian Development Bank, World Bank, European Bank for Reconstruction and Development, Islamic Development Bank, European Union, Japan International Cooperation Agency, Arab Coordination Group). Similarly, the energy transmission line and substation projects of China in the Kyrgyz Republic are consistent with the CASA-1000 design and CAREC energy sector plans. Some of the other donors' projects are implemented by Chinese companies (e.g. CRBC for ADB projects) serving as construction contractors. While the coordination of Chinese infrastructure projects with different donors does take place, many representatives of other donor organizations/governments keep indicating a lack of dialogue with the representatives of China in the Kyrgyz Republic (Wolters 2018). Possibly this dialogue takes place in the headquarters of international development organizations rather than

Figure 5: Trade in Services between the Kyrgyz Republic and China

(a) Exports of services from the Kyrgyz Republic (US\$ millions), 2016



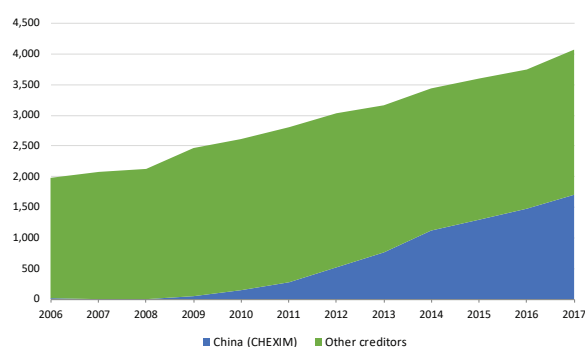
(b) Imports of services to the Kyrgyz Republic (US\$ millions), 2016



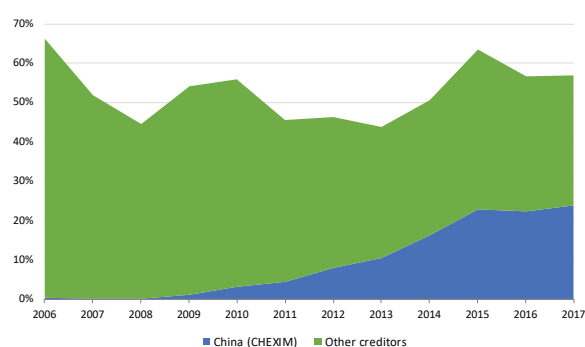
Source: National Statistical Committee of the Kyrgyz Republic, National Bank of the Kyrgyz Republic

Figure 6: Evolution of the External Government Debt of the Kyrgyz Republic

(a) Nominal value at the year-end (US\$ millions)



(b) Relative to the size of the economy (% of GDP)



Source: Ministry of Finance of the Kyrgyz Republic

in-country. The coordination could also be partially driven by the government of the Kyrgyz Republic, which tries to pool the resources of different donors for the country's key infrastructure projects.

There are ambitious plans of relevant governments to coordinate activities in the frameworks of the EAEU and the BRI. A practical step in this direction was the signing of the Agreement on Trade and Economic Cooperation between the EAEU and the PRC (17 May 2018). The agreement is reported to be non-preferential, but it includes different measures to foster mutual investments, simplify trade procedures and reduce or remove non-tariff barriers in trade between China and the EAEU member countries.

Some of the BRI-related projects mentioned above are simultaneously included in the EAEU's broad infrastructure development plans. For example, the alternative North-South road is also considered to be a section in the road connecting Russia and Kazakhstan with Tajikistan and South Asia.

Some of the BRI-related projects, especially energy-related ones, aim to increase the independence of the Kyrgyz Republic from regional energy markets. For example, the Datka-Kemin transmission line is reported to reduce the dependence of the national energy system on electricity transit via the energy systems of Kazakhstan and Uzbekistan. The purpose of the Bishkek HPP rehabilitation, among other things, was to allow utilization of locally produced coal instead of imported varieties of coal and black oil.

It is also worth mentioning that the relationships between the Kyrgyz Republic and its neighbors have the potential to affect the efficiency of some of the Chinese projects. For example, the profitability of the main Chinese FDI project in the Kyrgyz Republic, Zhongda oil refinery, suffers due to the decision of the government of Russia to exempt exports of oil products to the Kyrgyz Republic from export duties. This decision resulted in lower prices for Russian gasoline and diesel fuel on the Kyrgyz domestic market and created an unfavorable price situation for the oil products produced at Zhongda (see section 2.2 above).

3.4. Governance

BRI-related projects appeared to be well-integrated into the national development framework. The *National Sustainable Development Strategy of the Kyrgyz Republic for 2013-2017* (adopted in 2013) included all projects supported by the government of China. The near-final draft of the *National Development Strategy of the Kyrgyz Republic for 2018-2040* (likely to be formally approved by the end of

2018) also includes multiple references to the BRI and the need to seize the opportunities provided by this initiative.

The massive inflow of resources in the framework of BRI-related projects and the associated potential for rent-seeking behavior by government officials put pressure on the governance system of the country. The post-2010 political and social setup of the country provides for a substantial degree of transparency for all BRI-related activities. Texts of key agreements related to government loans received from CHEXIM and many details of Chinese FDI projects are open to public. The political competition and availability of influential forces in Jogoku Kenesh (parliament) opposing the government, frequent changes of Cabinets and the desire of new officials to distance themselves from previous Cabinets' deals lead to the revelation of many cases of inefficient use of resources or procurement and other procedural violations in the implementation of BRI-related projects which are associated with allegations of corruption (see Box 1). A large share of recent changes in government resulted from different scandals associated with the implementation of projects with Chinese participation.

The relationships of Chinese FDI projects with local communities are not simple either. People in the communities located near gold mines or oil refineries keep complaining about environmental damage and insufficient benefits for the communities from these projects. Sometimes these complaints take a form of open protests and even looting of the Chinese companies' property (Kudryavtseva 2018, Trilling 2014). These protests are based on a perception (grounded or not) that Chinese investors made a deal with authorities in Bishkek so that all benefits are going to be reaped by central government officials while the local elites and population are going to bear the projects' costs. While central government representatives usually try to swiftly cool passions down, they are not always successful in their dialogue with communities. The unwillingness or inability of the Chinese management of the companies to establish proper dialogue with the communities is another risk factor in such situations. However, Chinese companies are not unique in finding themselves in such situations. In the past, similar protests and conflicts took place around projects by Canadian, Kazakh and Russian investors; even Kyrgyz investors from Bishkek are not fully immune from these risks when implementing projects in rural/remote areas.

Available evidence suggests that people of the Kyrgyz Republic have mixed feelings about their country's relationships with China. According to the 2017 public opinion poll data, people of the Kyrgyz Republic positively assess the

Box 1: Domestic Political Dynamics around Chinese Participation in Infrastructure Projects in Bishkek in 2018

In January 2018, there was an accident at Bishkek HPP which left a large part of the city almost without heating amid unusually cold weather (below -20°C). Analysis of the accident revealed many major technical issues with the HPP's equipment and mismanagement of the enterprise. This sparked a very acute political debate in the government, parliament and society, as rehabilitation of the HPP was supported by US\$386 million loan from CHEXIM and implemented by the Chinese company TBEA (see Section 2.1). This rehabilitation had been just recently reported to be successfully completed. An investigation revealed that this loan aimed at rehabilitating only a part of the HPP while other parts (those that collapsed in winter) had not been fixed. This raised many questions about the efficiency of the HPP rehabilitation project when such a significant amount of money was not sufficient to rehabilitate the entire enterprise. Opposition politicians accused the government and the company TBEA of artificial inflating costs and corruption.

The then-Prime Minister and his Cabinet had to resign. As of end-August 2018, a criminal investigation was still ongoing, while two former Prime Ministers and some other government officials, as well as one representative of TBEA, have been placed in prison.

Around the same time, the Government concluded an investment agreement with the Chinese company Huawei Technologies for implementation of the Smart City project (video-control to enforce road rules on the streets of Bishkek and Osh and selected highways in the country). However, just two months later the Government announced that it had broken the agreement due to "inobservance of the agreement terms and provision of low quality documentation on the project" by Huawei. There is an opinion that the company just decided to stay away from this potentially controversial project at a time when another Chinese company, TBEA, was under a barrage of corruption allegations (Baktybaev 2018).

relationships with China (IRI 2017). 60 percent of respondents consider these relationships to be good, with 18 percent of respondents assessing them as negative. However, in answering the question "Which of these countries do you consider to be the most important economic partners and greatest economic threats to the Kyrgyz Republic?" 32 percent of respondents chose China as an important partner while 35 percent of respondents considered China as a threat. Other surveys and qualitative assessments of the public attitudes towards China and the BRI provide a similar mix of optimism and fear regarding economic relationships with China.

4. Potential Future BRI Activities and Impact

4.1. Investments

The ongoing road projects, when completed, would create a road network suitable for transit from China via the territory of the Kyrgyz Republic in almost all possible directions. Of course, there are a few more road projects that the government of the Kyrgyz Republic would like to implement (e.g. the Issyk-Kul ring road, which would be connected to Kazakhstan from its eastern portion and also via a shortcut road to Almaty), but it remains to be seen if these projects are of interest for China. In any case, these roads are not going to be transit routes.

A major project which has been under discussion for some 20 years is the China-Kyrgyz Republic-Uzbekistan railroad, with the Kyrgyz segment from the Torugart border crossing point to Jalal-Abad. This is expected to be a very

expensive project with costs around US\$5 billion (according to the Railway Strategy for CAREC, 2017-2030). While this railway may be useful for transit purposes (see below), it is not going to immediately serve much of the current domestic flows. Whatever route of the railroad is chosen (two options are being considered: North 472 km long and South 276 km long; as far as it is known, no decision on exact route has been taken yet), it is going to pass through mostly uninhabited parts of the Kyrgyz Republic with virtually no current economic activities. To make it useful for the domestic economy of the Kyrgyz Republic, another connecting railroad should be built to Balykchi (the endpoint of the current railway system in the north of the Kyrgyz Republic). If the northern route is chosen, the railroad would come closer to some mineral deposits, thus reducing the cost of developing them. However, if the main purpose to build the road is transit, then the shorter and cheaper southern route could be preferable.

It seems to be important to ensure that infrastructure development is accompanied by appropriate allocations for operations and maintenance of newly built and rehabilitated infrastructure. This may be done either through direct funding from the government budget (necessary allocations to be carefully assessed before initiation of any new infrastructure investment project), or by introducing or adjusting infrastructure user fees. This is of particular importance for the energy sector, in which energy tariffs are known to be set at an unsustainably low level (World Bank 2017).

In terms of FDI projects, their future prospects seem to depend on the sector considered. Mining projects would probably continue consuming a large part of Chinese FDI. The government of the Kyrgyz Republic should just make sure that tax revenue from these projects is substantial, as this is arguably the only reason to have them (since employment generated by mining activities is small, and environmental damage may be an issue). Projects in tourism and agriculture aimed at the Chinese market seem to be promising, but the government of the Kyrgyz Republic should help potential investors to build long-term mutually beneficial relationships with local communities.

The government of the Kyrgyz Republic proposes to move some industrial enterprises from China to the Kyrgyz Republic, following the pattern observed already in some countries of Southeast Asia. One could think of two possible rationales for such relocation of industries: (i) lower labor costs in the Kyrgyz Republic than in China, and (ii) easier, in terms of trade barriers and transportation costs, access to some third country markets (e.g. Russia and other EAEU countries) as the domestic market of the Kyrgyz Republic is small and may not justify any investments (as the example of Zhongda oil refinery seems to attest). Regarding labor costs, it follows from the indicative calculations provided in Table 3 that while wages in the Kyrgyz Republic are, indeed, much lower than in China, unit labor costs are 20 percent lower in China than in the Kyrgyz Republic. This is explained by much higher labor productivity in China.

On transportation costs, the savings from enterprise relocation to the Kyrgyz Republic would depend on the planned destination markets. For relatively distant markets (northern/western Kazakhstan, Russia, or the Middle East) where transportation costs could become an issue, railroads usually provide a cheaper option than automobile roads. The railroad system in the Kyrgyz Republic is not well developed and transport flows are highly asymmetrical, so rail transportation costs for imports to and exports from the Kyrgyz Republic are high and may remain high in the foreseeable future despite some infrastructure

improvements. On trade barriers, the Kyrgyz Republic has preferential access to the EAEU market, so if an enterprise is going to export those products which are highly protected in the EAEU by tariff barriers (EAEU membership seems to make little/no difference with regards to non-tariff barriers), then the Kyrgyz Republic would be an advantageous country of origin.

It also seems important for the Kyrgyz Republic to make sure that these enterprises, if relocated to the Kyrgyz Republic, are based on modern technologies rather than on outdated technologies and equipment.¹⁰ Technology transfer may be one of the key advantages of foreign (including Chinese) FDI, and this type of considerations may need to be prioritized by the Kyrgyz government.

For the Kyrgyz Republic, environmental considerations seem to be of high importance, too. The country has serious ambitions for the development of tourism and organic agriculture/food production. Thus, any harmful industrial emissions are going to be counterproductive. This means that a very careful analysis of industrial investment projects is needed to decide on their feasibility for both countries.

4.2. Trade

BRI-induced trade flows in the Kyrgyz Republic may be grouped into two categories: (i) trade in goods and services between the Kyrgyz Republic and China/third countries in which the Kyrgyz Republic is *either the origin or the destination country*, and (ii) trade in transport services in which the Kyrgyz Republic would just offer its infrastructure for *transit* of goods between China and other countries.

A major part of the justification for mega transport infrastructure projects implemented in the Kyrgyz Republic and some other countries covered by BRI is the possibility of transit of goods between China and Europe/West Asia. There is quite a literature discussing the impressive amount of goods transported from China to the West and (to a lesser extent) back, and the speed and timeliness gains produced by using surface (automobile road and railroad)

10. The oil refineries mentioned in Section 2.2 seem to rely on outdated technologies as these enterprises need a serious upgrade just two or three years after their launch.

Table 3: Unit Labor Costs in China and the Kyrgyz Republic, 2017

| | China | Kyrgyz Republic |
|---|--------|-----------------|
| Average wage (PPP), international dollars per month | 1,745 | 683* |
| GDP per employed (PPP), international dollars per year | 27,153 | 8,565 |
| Unit labor costs, % of GDP per employed | 77.1 | 95.6 |

Source: WDI, National Statistical Committee of the Kyrgyz Republic, tradeeconomics.com, own calculations

* This average wage is for the formal urban sector, which represents a smaller part of the economy of the Kyrgyz Republic (according to official statistics, more than 70 percent of all employed work in informal economy). If incomes of workers in informal economy are lower than in formal, then the average wage value reported in the table may be biased upwards. It might be that the respective value for China is also for the formal sector. A detailed sector-specific analysis is needed in order to more accurately assess the unit labor costs ratio.

transport in comparison to using more traditional maritime routes. Fewer papers, however, provide any assessment of the volume of these flows for which this speed increase could be critically important and could justify much higher transportation costs when rail and especially automobile transport is used. The recent study of EDB indicates that only a small fraction (though still a very large number in absolute terms) of total trade flow between China and Europe could be shifted from sea to surface routes if all infrastructure and regulatory issues are addressed (Vinokurov et al. 2018). Also, it seems that the rail and automobile road network developed in the BRI framework is redundant in a technical sense: there are many competing routes leading in roughly the same direction from China to the West (via Russia only; via Kazakhstan to Russia and Europe; via Kazakhstan, the Caspian Sea, Caucasus and Black Sea/Turkey to Europe and the Middle East; via the Kyrgyz Republic, Tajikistan and other Central Asian countries to Afghanistan and West Asia; via Pakistan to Indian Ocean sea ports and West Asia). It seems this redundancy is intentionally designed as it provides a lot of flexibility and competition between different routes. This approach may be justified for the PRC from a strategic point of view, but it also means that in any normal situation each of these routes would serve only a fraction of its maximum transit capacity. Then, for the Kyrgyz Republic, a realistic assessment of the transit flows and associated revenue from transit service exports is needed. This, in turn, should feed into the assessment of the feasibility of borrowing for the transit railroad (China-Kyrgyz Republic-Uzbekistan).

For non-transit trade in which the Kyrgyz Republic is one of the trading parties, the transport infrastructure does not seem to be the main impediment anymore. Despite dramatic improvements in road connectivity in all possible directions (some road projects mentioned in Section 2.1 are not completed yet, but many roads have been rehabilitated already), the volumes and values of export and import flows did not grow for the last several years (see Figure 4). This may indicate that the constraints associated with supply (too few competitive goods to export from the Kyrgyz Republic), demand (saturation of the domestic market with imports at currently achieved GDP level) and some trade costs (insufficiently developed logistical services, delays at borders, high EAEU tariffs for some goods) are more important than transportation costs. Then, FDI into export-oriented enterprises and associated imports of equipment and production inputs may be the main drivers of trade associated with BRI implementation. Based on the available data on FDI and associated trade flows

(see above), one can estimate that US\$1 in additional FDI has so far generated some US\$0.05–0.10 in annual export flows¹¹ and US\$0.90 in import flows.¹²

So far, investments in the mining sector remain the main part of Chinese FDI in the Kyrgyz Republic (see Section 2.2). One could expect this situation to last, and gold/gold concentrate may remain the key export commodity of the Kyrgyz Republic in trade with China. Thus, for the Kyrgyz government the main challenge seems to be to ensure the effective protection of Chinese investments in the sector, the mediation of relationships with the local population (see Section 3.4), and the establishment of proper taxation of the sector, which would produce more revenue for the government budget (see Section 3.1).

It seems that the Kyrgyz Republic should eventually reorient its agrifood exports (currently up to 20 percent of total exports of goods) towards China. This is a huge market for Kyrgyz fruits, vegetables, meat, and dairy products. So far there are no exports of these products to China due to several reasons: veterinary and phytosanitary issues with Kyrgyz produce and its compliance with the regulations on access to the market of China; lack of Chinese market knowledge (including language barriers) among Kyrgyz businesspeople involved into agrifood trade; the very limited access of Kyrgyz trucks to the territory of China,¹³ which requires any Kyrgyz produce intended for export to China to be reloaded to Chinese tracks—this causes delays and increases transportation costs for Kyrgyz exporters. It seems that in the medium term the only feasible option for such exports would be to have them operated by Chinese trading companies. This would, of course, reduce profit margins for Kyrgyz producers and traders. On the other side, there is also the challenge of consolidating sufficiently large quantities of exports from mostly small Kyrgyz producers to make this import business attractive for Chinese companies. So, the prospects of this type of export to China seem to very much depend on the inflow of Chinese FDI into the agrifood sector of the Kyrgyz Republic; it would be easier for Chinese companies to organize production so it complies with the technical regulations and market requirements of China. And, of course, these Chinese FDI projects may aim

11. E.g. total cumulative FDI in the mining sector (inclusive of geological explorations) for 2006–2017 was US\$1.2 billion, and these investments generated exports of gold ore and concentrate of US\$121 million for the same period of time. The export returns on investments in oil refineries are much smaller so far.

12. Almost all these investments are spent on imports of equipment, inputs, and construction and engineering services from abroad (China).

13. This is related not to road infrastructure (it is already decent), but to Chinese regulations disallowing foreign trucks to go deep into the territory of China (possibly for security reasons).

also at exporting not only to China, but also to the EAEU and other markets outside of China. In assessing the prospects of FDI in Kyrgyz agriculture, one should also account for the fact that the Kyrgyz legislation prohibits land ownership by foreign legal entities and individuals. Managing relationships with the local population would probably be as serious an issue in agricultural investment projects as it is in mining.

One potentially prospective and currently almost untapped export sector for the Kyrgyz Republic is tourism. According to the World Tourism Organization's data, in 2015 the Kyrgyz Republic received 49 thousand tourists from East Asia and the Pacific (includes China), or just 1.6 percent of the total number of international tourists arriving in the Kyrgyz Republic that year. The National Statistical Committee data (Figure 5) provide similar picture: in 2016, exports of tourism services to China were only US\$8.6 million, or 2.0 percent of total exports of tourism services. It seems that with the growing middle class in China there should be considerable potential for increases in the number of Chinese tourists and tourism receipts from them. Thus, this may become an attractive sector for Chinese FDI in the BRI context, including investments in environmental protection for vulnerable natural destinations (e.g. Issyk-Kul lake or mountainous areas). Along with commercial considerations, this would also strengthen the reputation of the government of China as a responsible actor that cares about the environment in receiving countries.

4.3. Macroeconomics and Debt

Implementation of any BRI projects in the Kyrgyz Republic (either infrastructure investments or FDI in manufacturing, agriculture or services) may produce significant effects on the macroeconomic situation in the Kyrgyz Republic. The GDP and employment effects from construction associated with these projects would probably be short-term and, arguably, limited (as mentioned above, these works are done by mostly Chinese companies and workers using mostly Chinese inputs). The main macroeconomic effect of these projects could and should be in increasing the Kyrgyz economy's total factor productivity (TFP), which implies an increased export orientation of the economy, lower trade costs, better market linkages, introduction of modern and environment-friendly production technologies, etc. Economic growth caused by the TFP effects may also be the most promising in terms of employment generation, as such projects would create new jobs requiring higher-skilled labor. So, efficiency considerations may become a matter of primary interest when

BRI projects are planned in the country. Another dimension of BRI projects of substantial interest could be the government revenue generated by these projects. As the evidence provided in Section 3.1 suggests, manufacturing enterprises may become major taxpayers; the transit road projects, if properly taxed, could also bring in substantial money to the budget.

Subnational allocation of the projects and the impact of these projects on the development of the Kyrgyz regions may be another important dimension of these projects' evaluation. It is a clear priority of the Kyrgyz government to ensure that rural, remote and mountainous parts of the country receive a fair share of total investments and development projects. On the other side, it may not be of great interest for investors to locate their enterprises in the parts of the country that are more difficult to access and supply with labor, energy and other production resources. So, the contribution of BRI (and, in fact, any other foreign/domestically financed) projects towards the regional development of the Kyrgyz Republic would depend on the success in providing investors with proper incentives to operate in these less accessible and developed parts of the country. Another type of activity to facilitate the inflow of FDI to the regions of the Kyrgyz Republic would be the development of secondary and tertiary infrastructure (e.g. roads, energy distribution networks) serving the areas hosting these FDI enterprises.

The external government debt situation should continue to be carefully monitored and analyzed. New public infrastructure projects may need to be approved only if it is very clear that they would generate enough government revenue and export receipts to ensure accurate servicing of the debt. This may require much stricter selection of the projects to be implemented than before. Different flexible forms of public-private partnerships which do not involve government borrowing (concessions, FDI into infrastructure, etc.) may need to be explored and promoted.

5. Recommendations

5.1. For the government of the Kyrgyz Republic:

- Provide effective support to and protection of Chinese and other foreign investors in their relationships with the local population;
- Make sure that newly built enterprises with foreign investments in the Kyrgyz Republic are going to use modern and environment-friendly technologies and that technology transfer to local engineers/

managers/skilled workers is being conducted as a part of these enterprises' business practices;

- Continue/expand participation in regional integration initiatives (e.g. CAREC) to optimize investments and lower costs of trade, transit and participation in international value chains for Kyrgyz enterprises;
- Maintain the sustainability of the external debt of the government by avoiding excessive borrowing even at concessional terms;
- Develop/strengthen appropriate legislation and practices for infrastructure investment projects which would not require sovereign borrowing by the government;
- Assure that operations and maintenance requirements of infrastructure investments are appropriately managed and necessary resources are allocated from the government budget or mobilized as infrastructure user fees;
- Develop infrastructure which is necessary for tourism exports (airports, waste management facilities in the key tourism destinations, etc.);
- Develop secondary and tertiary infrastructure in the regions hosting FDI projects;
- Provide incentives for those investors which locate their enterprises in remote parts of the country;
- Modify the taxation regime for the mining sector and develop a taxation regime for railway and automobile road transit to ensure an appropriate level of government revenue from this sector.

5.2. For the Kyrgyz private sector and civil society organizations:

- Explore opportunities for exports to the Chinese market and study Chinese legislation and business practices in order to effectively utilize the increasing openness of China in the BRI context;
- Provide monitoring and early warning on implementation of the BRI and similar projects to ensure explicit accounting for not only financial/commercial effects, but also social and environmental effects of these projects, and to prevent any conflicts associated with these projects.

5.3. For the government of the People's Republic of China:

- In the framework of the BRI, support projects aimed at environmental protection in partner countries; integrate environmental safeguards into all BRI infrastructure and FDI projects;

- Develop project financing modalities which would be suitable for fair risk sharing when projects cover several countries;
- Provide appropriate training to Chinese enterprise managers to prepare them to deal with local populations and to avoid/minimize any potential conflicts.

5.4. For international development partners:

- Provide technical assistance to the governments of receiving countries in developing methodologies for economic, social and environmental assessment of large infrastructure and FDI projects, whether these are part of the BRI or any other initiative;
- Continue/improve coordination of infrastructure project planning and implementation between international financial institutions and the government of China.

6. Topics for Future Research

The analysis provided above seems to indicate a few areas requiring more in-depth research:

- Many BRI projects are motivated not only/not so much by pure economic rationale, but by strategic/geopolitical considerations, with gains from these projects possibly materializing only over the (very) long term. Still, short- and medium-term costs of these projects (e.g. the risks to external debt sustainability for participating governments) could be very significant. Very optimistic assumptions on the guaranteed net economic value of these projects may need to be carefully checked. A thorough analysis of expected financial, economic, social, and environmental benefit and cost flows of large BRI projects seems to be necessary for both Chinese investors and receiving governments.
- Some of the large BRI projects (e.g. transport corridors) might cover more than two countries. It seems that in these projects the scale and distribution of benefits, costs and associated risks are even less clear than in other long-term projects. The methods of risk management in such multi-country infrastructure projects may need to be developed and risk assessments conducted for these projects.
- It would be important to conduct an assessment of the seeming redundancy of planned trans-continental infrastructure and get a better understanding of the scale and direction of potential trade and transport flows from China to Europe and West

Asia which are going to use the newly developed infrastructure.

- Regarding the relocation of some industries from China to the Kyrgyz Republic and some other countries of the region, a deeper analysis of unit labor costs may need to be conducted and the probability of receiving Chinese FDI in manufacturing assessed.

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The Belt and Road Initiative in the South Caucasus Region

Giorgi Khishtovani, Mariam Zabakhidze, Irakli Gabriadze, and Rezo Beradze

1. Executive Summary

The Belt and Road Initiative (BRI), according to Chinese officials, intends to improve connectivity through Asia, Europe and Africa. The BRI is seen as a game-changer, as it promises to have an impact on more than 4 billion people in more than 65 countries across Asia, Europe and Africa (Tung 2016). The South Caucasus region, at the crossroads between Europe and Asia, certainly comes under the focus of the BRI. This country note evaluates the potential outcomes/impacts of the BRI on the South Caucasus region by reviewing the current political and economic situations of Armenia, Azerbaijan and Georgia and outlining their current and future engagement in the BRI.

Armenia, Azerbaijan and Georgia share many similarities as former Soviet Union countries who regained their independence in the early 1990s. Russia's occupation of two Georgian regions and the conflict between Armenia and Azerbaijan over Nagorno-Karabakh makes the region politically complex. Having advanced relationships with Azerbaijan and Turkey as well as with Armenia, Georgia plays a pivotal role in regional connectivity and coordination. Moreover, among the three countries of this region, Georgia is the most politically stable, with the highest position in the Ease of Doing Business Index, Index of Economic Freedom and Corruption Perception Index. However, Azerbaijan, having by far the largest economy in the region (bigger than the economies of Armenia and Georgia combined) due to its oil and gas reserves, also plays an important role in the region.

What all three countries in the South Caucasus region share is the need to modernize their infrastructure and boost trade opportunities. Long before the BRI, hard infrastructure connectivity had been prominent on the regional agenda. Relevant projects have been initiated as part of two major infrastructure development trajectories in the region: (1) the Asian Development Bank-initiated Central Asia Regional Economic Cooperation (CAREC) Program, launched in 1997; and (2) the EU-led link between the South Caucasus and Central Asia (TRACECA), launched

in 1993. More recently, completion of the Baku-Tbilisi-Kars (BTK) railway, and developments along the Trans-Caspian International Transport Route (TITR), linking Kazakhstan, Azerbaijan, Georgia and Turkey, have been considered as contributing towards the China-Central Asia-West Asia corridor under the BRI. In addition, the first phase of the Anaklia Deep-Sea Port in Georgia and the renovation of Alat Port in Baku are also labeled as BRI projects in the South Caucasus. Major pipelines such as the Baku-Tbilisi-Ceyhan (BTC) oil pipeline and the Baku-Tbilisi-Erzurum (BTE) pipeline, also referred to as the South Caucasus pipeline (SCP), are already operating across the region and could also fall into the BRI narrative. Furthermore, in this context, the Trans-Anatolian Natural Gas Pipeline Project (TANAP) is also relevant and has attracted interest from China. Most recently, the AIIB approved its biggest loan so far for the construction of a gas pipeline connecting Azerbaijan with Turkey and Southern Europe.

Due to its land borders being closed with Azerbaijan and Turkey, Armenia's regional connectivity is quite limited. A multimodal transport corridor, the Persian Gulf-Black Sea corridor, is one of the very few options available for Armenia to become involved in the Initiative. This corridor envisages connecting Iran with Europe via Armenia and Georgia.

Although there are some projects that can be linked to the BRI, it is still difficult to evaluate the impact of the Initiative on the South Caucasus region. Nonetheless, this report has identified that for the South Caucasus region the Belt and Road Initiative can serve as a means of:

- Diversifying economic activities;
- Improving coordination between projects and perhaps harmonizing them under one umbrella (one aim);
- Catalyzing better regional coordination and attracting more investors; and
- Focusing on the region not only as a transit corridor but also as an economic corridor by making greater use of relatively cheap labor and other resources

coupled with establishing closer ties with the EU and other markets such as the Eurasian Economic Union (EAEU).

However, to build on the incentives coming from the BRI, the countries of the South Caucasus need to achieve better coordination to make the region more attractive and competitive. Due to the political tension between Armenia and Azerbaijan, it is not particularly likely that the South Caucasus countries will adopt a common coordinated policy approach towards the BRI; however, bilateral cooperation (Georgia-Azerbaijan; Georgia-Armenia) has been proven possible given the already existing activities. In this regard, apart from hard infrastructure projects, countries should focus on soft infrastructure tools like unified tracking and tracing systems.

Furthermore, as Armenia, Azerbaijan and Georgia cannot afford financing large investment projects by themselves, they have to take into consideration the associated risks. Thus, the fiscal flexibility of these countries makes a significant difference. In particular, it is important to assess the risks South Caucasus countries are facing by increasing their levels of indebtedness.

Based on the analysis, it is clear that the BRI is still unfolding and, due to its scale, it is somewhat difficult to pin down. The main concern related to the BRI is unpacking what are likely to be the real objectives behind the Initiative. Would investment and trade be driven by market-based transactions, or would they be a form of foreign aid that is not based on economic gains and losses? Which of the numerous countries in Asia, Europe and Africa along the Belt and Road will likely be the Initiative's core targets of economic cooperation?

This paper evaluates the potential outcomes/impacts of the BRI on the South Caucasus region. The first chapter briefly presents country profiles of Georgia, Armenia and Azerbaijan, followed by an evaluation of the current level of engagement of these countries in the BRI. The potential outcomes/impacts are presented in the following chapter. Lastly, based on the analysis, gaps and areas for future research are identified, along with some recommendations for the governments of the South Caucasus countries, for investors/donors, for the Chinese government, and for private entities.

2. South Caucasus Region: Overview

The South Caucasus (SC) region (Armenia, Azerbaijan, and Georgia), situated at the crossroads between Asia and Europe, is geopolitically significant and politically complex. The importance of the region is amplified by the existence

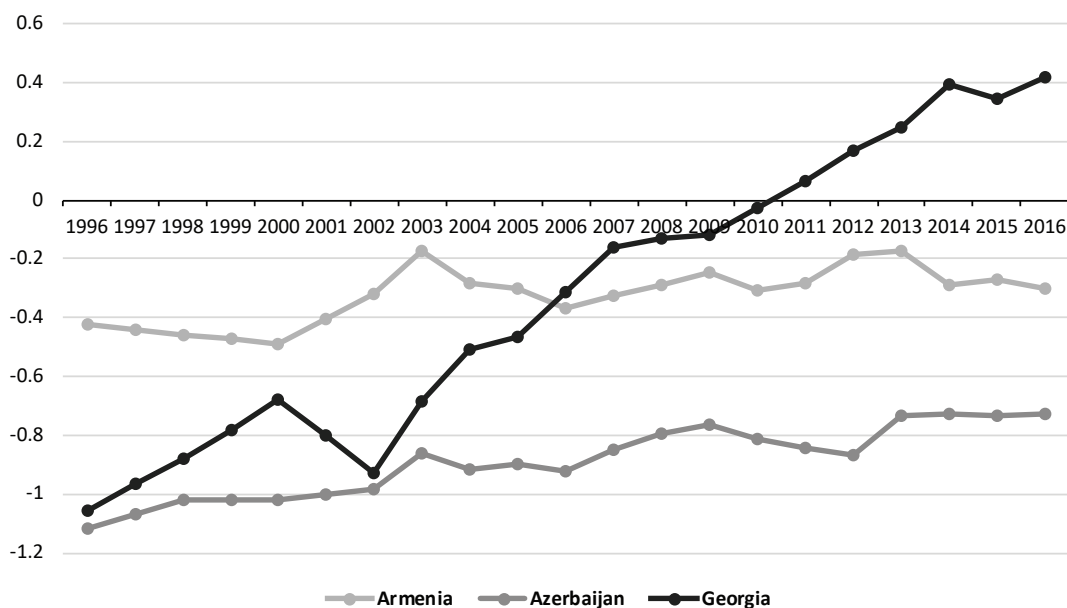
of gas and oil reserves in the Caspian Basin and neighboring Central Asia. Apart from natural resources, improved infrastructure is anticipated to make it easier to transport goods from East Asia to Western Europe, leading to larger trade/cargo flows through the region. However, the need for better connectivity is hindered by some critical obstacles. For example, Georgia, due to its NATO and EU aspirations, is opposed by Russia at various levels, with this tension exploding into armed conflict in 2008, as a consequence of which Russia now occupies two Georgian regions¹. In addition, the conflict between Armenia and Azerbaijan over Nagorno-Karabakh has resulted in the closing of borders between both Armenia and Azerbaijan and Armenia and Turkey (Azerbaijan's close ally). Armenia keeps close ties with Russia, which has a large military base located in the country. Having advanced its relationships with Azerbaijan and Turkey as well as with Armenia, Georgia plays a pivotal role in regional connectivity and coordination.

In the SC region, Azerbaijan's economy is by far the biggest, greater than those of Armenia and Georgia combined. With a population of over 9.9 million, as of 2017, the total GDP of Azerbaijan was around US\$40.5 billion, while Georgia (population 3.7 million) and Armenia (population 2.9 million) recorded US\$15.2 billion and US\$11.5 billion respectively (World Bank 2018a).

In terms of political stability and transparency, Georgia ranks highest among these three countries. According to the World Bank's World Governance Indicators (WGI), Georgia has the highest average institutional quality (see Figure 1).

A similar trend is observed when it comes to freedom and democracy. According to the Freedom House Index, Georgia and Armenia are partly free, with scores of 64 and 44 out of 100, respectively. Meanwhile, Azerbaijan is currently classified as not a free country, scoring only 12 points (Freedom House 2018). Nonetheless, although Georgia ranks 9th in the world in the Ease of Doing Business Index and 16th in the Index of Economic Freedom, high unemployment and challenging socio-economic conditions are dominant features of its current economic environment. Those challenges are similar in Armenia, which is ranked 47th in the latest Ease of Doing Business Index and 44th in the Index of Economic Freedom. As for Azerbaijan, the main challenge for its economy is its high dependency on natural resources. In terms of international rankings, Azerbaijan has the least favorable results among

1. Formally, Russia recognized the independence of Abkhazia and South Ossetia, the regions of Georgia accounting for 20 percent of the country's territory.

Figure 1: Average Institutional Quality (unweighted average of six WGI indicators)

Source: World Bank (2018)

Table 1: Key indicators for Armenia, Azerbaijan and Georgia

| Indicator | Armenia | Azerbaijan | Georgia |
|--|---------|------------|---------|
| Population (million) | 2.9 | 9.8 | 3.7 |
| GDP, 2017 (US\$ billions) | 11.5 | 40.7 | 15.2 |
| GDP per Capita, 2017 (US\$) | 3,860 | 4,140 | 4,090 |
| GDP per Capita PPP, 2017 | 9,480 | 17,530 | 10,740 |
| Freedom House Index, 2018 (Score) | 44 | 12 | 64 |
| Ease of Doing Business, 2018 (Rank) | 47 | 57 | 9 |
| Index of Economic Freedom, 2018 (Rank) | 44 | 67 | 16 |
| Corruption Perception Index, 2017 (Rank) | 107 | 122 | 46 |

Source: IMF, World Bank, Freedom House, Heritage Foundation, Transparency International

the SC countries, as the country ranks 57th and 67th in the Ease of Doing Business Index and the Index of Economic Freedom, respectively (Heritage Foundation 2018, World Bank 2018b). In terms of good governance, Azerbaijan faces the most challenging situation in the region, with the lowest score in Transparency International's Corruption Perception Index, ranking 122nd out of 180 countries, whereas Armenia holds 107th place and Georgia is 46th (Transparency International 2017). Table 1 summarizes the main indicators for SC countries.

Even though the SC countries have made significant progress, they still face serious socio-economic problems. Decades of hardship have affected the living standards of much of the population of Georgia, 21 percent of which still lives below the poverty line (ADB 2017b). Unbalanced

economic growth and a weak export structure² coupled with regional political and economic fluctuations have all resulted in relatively slow economic growth. The main sources of growth have been the service sector (including tourism, transport, real estate and finance) and construction, with the economy now significantly dependent on these areas. In the SC region, Georgia is regarded as an open economy, having signed several strategic trade agreements including the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU, free trade agreements (FTAs) with CIS countries, Ukraine, Turkey and EFTA Countries, and most recently a free trade agreement with China (including Hong Kong). All of these could potentially

2. Due to its weak industrial and agricultural sectors, Georgia's export portfolio is not particularly diversified. Most of its exported goods are commodities with low added value, and these are highly vulnerable to volatile world-market prices.

support export diversification and increase FDI flows into the country, which in turn would require better connectivity.

Armenia's economic integration in the SC is limited due to its closed borders with Azerbaijan and Turkey. Today, Armenia has open borders with two countries, Georgia to the north and Iran to the south. Furthermore, Armenia is highly dependent on Russia economically (its top trading partner) as well as politically. In January 2015, Armenia became a member of the Russia-led Eurasian Economic Union (EAEU), which gives Armenia access to a single Eurasian economic market of 180 million people (KPMG 2016 in Inan & Yayloyan 2018). However, as Armenia does not share a border with any of its member countries, to benefit from the agreement the country needs better connectivity with neighboring Georgia, which is the main transit country for Armenia's exported and imported goods. On 24 November 2017, Armenia and the EU officially signed the Comprehensive and Enhanced Partnership Agreement (CEPA), giving the country a GSP+ trade regime and the potential to increase its trade volume with the EU.

Azerbaijan's political and economic development has been heavily dependent on its natural resources, particularly its oil and gas reserves that, according to UNCTAD data of 2017, accounts for 90 percent of the country's total exports (UNCTAD 2018a). According to an IMF report, Azerbaijani oil reserves will last for another 15-20 years, highlighting the fact that Azerbaijan's "oil dependence and fiscal vulnerabilities are rapidly increasing" (Albino-War & Quillin 2013). Therefore, to reduce this dependence, Azerbaijan has made substantial investments in the Trans-Caspian trade corridor and has signed multiple agreements relating to the Trans-Caspian transport network³. However, in 2014, when Georgia signed an Association Agreement (AA) with the EU, Azerbaijan rejected the EU's offer to do likewise. Meanwhile, the country has also not expressed an interest in joining the EAEU as it tries to keep a balance between Russia and the West.

Based on the discussion above, it is apparent that all three countries need better connectivity to overcome their

3. For instance, the TITR project, which is an extension of TRACECA, could be regarded as an attempt by the railway and port authorities of Azerbaijan, Kazakhstan, and Georgia to address tariff issues.

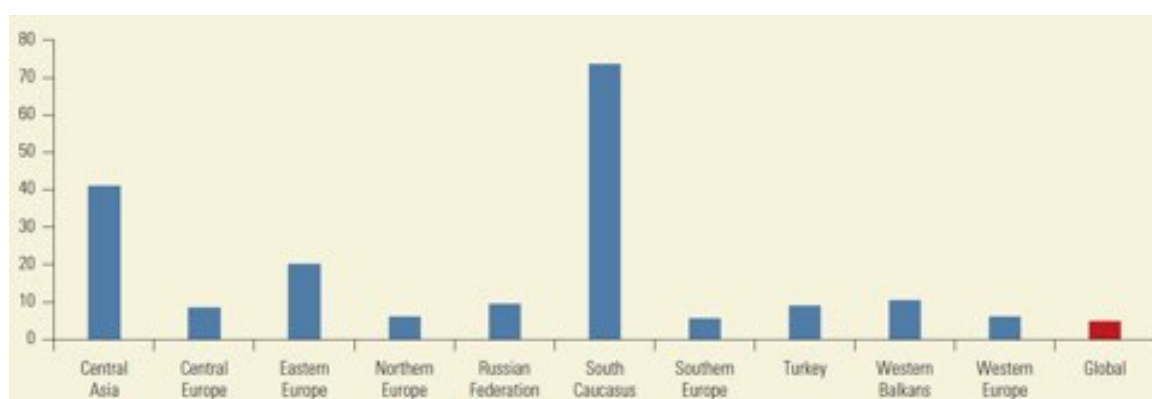
Table 2: Multidimensional Connectivity Indices (on a per capita basis; lowest means best)

| Country | Multi-dimensional connectivity | Trade | FDI | Migration | ICT | Airlines | Portfolio Flows |
|-----------------------|--------------------------------|-------|-----|-----------|-----|----------|-----------------|
| Western Europe | 6 | 6 | 6 | 9 | 9 | 15 | 19 |
| Turkey | 56 | 55 | 57 | 39 | 76 | 62 | 85 |
| Eastern Europe | 62 | 59 | 60 | 81 | 54 | 57 | 76 |
| Central Asia | 94 | 99 | 93 | 101 | 101 | 103 | 101 |
| South Caucasus | 104 | 104 | 102 | 64 | 104 | 104 | 93 |
| Georgia | 84 | 102 | 65 | 63 | 98 | 99 | 90 |
| Armenia | 87 | 90 | 70 | 77 | 89 | 79 | 81 |
| Azerbaijan | 106 | 106 | 107 | 87 | 103 | 93 | 106 |

Source: World Bank

Note: FDI = foreign direct investment; ICT = information and communication technology

Figure 2: Growth in Connectivity (percent), 2000-14



Source: World Bank

economic challenges. Considering the regional context, it is difficult to find ways to improve connectivity, but there is some potential. The room/need for improvement in terms of connectivity in the region is apparent from Table 2, which depicts World Bank's Multidimensional Connectivity Index for the SC region and neighboring regions. According to the index, Western Europe has the best Connectivity Index and the SC region has the worst. Among the SC countries, Georgia has the best connectivity, followed by Armenia and then Azerbaijan.

However, it should also be mentioned that, during 2000-2014, the SC region has increased connectivity by nearly 75 percent, which is by far the best result across all regions. This improvement in connectivity in the SC region has been driven by a number of external actors, such as the EU, Russia, the USA, Turkey, and China, all of which have their own interests in the region. This has been embodied in different projects, including the EU-led Transport Corridor Europe-Caucasus-Asia (TRACECA), the Asian Development Bank-led Central Asia Regional Economic Cooperation (CAREC) Program, and most recently the China-led Belt and Road initiative (BRI). In the following section, these overlapping projects will be discussed in more detail, with a particular focus on the BRI.

3. The BRI in the South Caucasus Region: Current Involvement

It is challenging to identify the specific date on which the BRI landed in the SC region. However, a range of events have contributed to the current state of engagement of the SC countries in the Initiative. This section outlines the current level of involvement of SC countries in the BRI by focusing on the main areas of BRI engagement (transport connectivity and trade). However, so far there has been no

direct Chinese investment in the ongoing projects, even though the corridors they support are very much part of the corridors envisaged by the BRI.

3.1. Infrastructure Connectivity

Hard infrastructure connectivity has been prominent on the agenda in the SC region for more than two decades. Since long before the announcement of the BRI, two countries of the SC (Georgia and Azerbaijan), together with Turkey and two countries of Central Asia (Kazakhstan and Turkmenistan), have been working towards the improvement of regional connectivity. Moreover, relevant projects have been initiated as part of two major infrastructure development trajectories in the region: (1) the Asian Development Bank-initiated Central Asia Regional Economic Cooperation (CAREC) Program, launched in 1997; and (2) the EU-led links between the South Caucasus and Central Asia (TRACECA), launched in 1993 (Table 3 provides more detailed information about these initiatives). However, as myriad studies show, the region is still lagging behind in terms of infrastructure connectivity, mainly due to deficiencies such as gauge size differences, tariffs and border-crossing variances (Inan & Yayloyan 2018, World Economic Forum 2014).

Oil and Gas Pipelines

Historically, outside interest in the SC region has been mainly driven by the rich oil reserves of the Caspian Sea. Thus, some major pipelines such as the Baku-Tbilisi-Ceyhan (BTC) oil pipeline⁴ and the Baku-Tbilisi-Erzurum (BTE)

4. Backed by Western companies led by BP, the BTC pipeline became operational in 2005. It serves as Azerbaijan's main export pipeline.

Table 3: Initiatives Involving the South Caucasus Region

| Initiative/ Project Name | Launch date | Short Description | Financed by | Countries Involved | Status |
|-----------------------------|----------------|--|---|---|---------|
| TRACECA | 1993 | TRACECA is an internationally recognized program aimed at strengthening economic relations, trade and transport communication in the regions of the Black Sea basin, South Caucasus and Central Asia owing to active work based on political will and common aspirations of all member-states. | European Commission and various IFIs (EBRD, ADB, EIB). | Azerbaijan, Armenia, Georgia, Iran, Kazakhstan, Kyrgyz Republic, Moldova, Romania, Tajikistan, Turkey, Ukraine, Uzbekistan | Ongoing |
| CAREC | 1997 | The CAREC Program entails the partnership of 11 countries and development partners working together to promote development through cooperation, leading to accelerated economic growth and poverty reduction. It is guided by the overarching vision of "Good Neighbors, Good Partners, and Good Prospects." | Asian Development Bank and various IFIs (EBRD, IMF, ISDB, UNDP, World Bank) | Afghanistan, Azerbaijan, People's Republic of China, Georgia, Kazakhstan, Kyrgyz Republic, Mongolia, Pakistan, Tajikistan, Turkmenistan, Uzbekistan | Ongoing |

Source: TRACECA (2018), CAREC (2018)

Figure 3: Major Oil and Gas Pipelines in the South Caucasus Region



Source: U.S. Energy Information Administration and IHS EDIN

pipeline, also referred to as the South Caucasus pipeline (SCP)⁵, are already operating across the region.

Furthermore, due to growing interest from Europe in becoming less dependent on Russian energy, the building of alternative pipelines through the SC region has been ongoing for some time. For example, despite constant opposition from Russia, the Trans-Caspian energy corridor from Turkmenistan and Kazakhstan to Turkey via Azerbaijan and Georgia has been around since the 1990s

5. Connects Azerbaijani Shah Deniz fields with Erzurum in Turkey through Georgia.

Figure 4: Southern Gas Corridor Program



Source: GSDPM

(Wheeler 2013). In this context, the Trans-Anatolian Natural Gas Pipeline Project (TANAP) is also relevant. Most recently, the AIIB approved its biggest-ever loan for the construction of a gas pipeline connecting Azerbaijan with Turkey and Southern Europe. Azerbaijan received US\$600 million designated for the TANAP which, when completed, will transport natural gas from fields in Azerbaijan via Georgia across Turkey and then onward to markets in Southeastern Europe (Suokas 2016).

Railway

Part of the BRI (or the “Belt,” also referred to as the concept of the “Silk Road Economic Belt” [SREB]), aims

Table 4: Summary of Oil- and Gas-related Projects in the South Caucasus Region

| Initiative/ Project Name | Launch date | Short Description | Financed by | Countries Involved | Status |
|---|-------------|---|---|--|-------------|
| Baku-Tbilisi-Ceyhan (BTC) oil pipeline | 2005 | The pipeline carries oil from the Azeri-Chirag-Deepwater Gunashli (ACG) field and condensate from Shah Deniz across Azerbaijan, Georgia and Turkey. Its length is 1,768km in total: 443km in Azerbaijan, 249km in Georgia, and 1,076km in Turkey. The Azerbaijani and Georgian sections of the pipeline are operated by BP on behalf of its shareholders in BTC Co., while the Turkish section is operated by BOTAS International Limited (BIL). | British Petroleum holds the majority of shares (30.1%) followed by AzerBTC limited (25%) and Chevron (8.9%) | Azerbaijan, Georgia, Turkey | Operational |
| Baku-Tbilisi-Erzurum gas pipeline | 2006 | The South Caucasus pipeline (SCP) was built to export Shah Deniz gas from Azerbaijan to Georgia and Turkey. The pipeline starts from the Sangachal terminal near Baku. It follows the route of the Baku-Tbilisi-Ceyhan (BTC) crude oil pipeline through Azerbaijan and Georgia to Turkey, where it is linked to the Turkish gas distribution system. During the first half of 2018, SCPX activities continued successfully along the pipeline route across Azerbaijan and Georgia. All infrastructure across Azerbaijan and Georgia required to support the first commercial gas deliveries to Turkey were completed on schedule and were ready to operate before commencement of export on 30 June 2018. | BP, operator (28.8%), AzSCP (10.0%), TPAO (19 %), Petronas (15.5%), Lukoil (10 %), NICO (10%) and SGC Midstream (6.7%). | Azerbaijan, Georgia, Turkey | Ongoing |
| Trans-Anatolian Natural Gas Pipeline (TANAP) | 2015 | TANAP, combined with the SCP and the Trans-Adriatic Pipeline (TAP), forms the Southern Gas Corridor. It aims to transport gas from Azerbaijan's Shah Deniz II field in the Caspian Sea, as well as from other fields from the south of the Caspian Sea, to Turkey and Europe. | Multiple IFIs, including the World Bank, AIIB | Turkey, TANAP; Georgia and Azerbaijan, SCP | Ongoing |

Source: BP (2018), TANAP (2018)

Figure 5: TRACECA Corridor



Source: Davydenko et al. (2012, p. 140)

to build railway and road infrastructure linking China to Europe through Central Asia, Russia and the SC. It is not yet possible to exhaustively list all possible routes and trade corridors connecting China to Europe. However, one of the anticipated trade corridors is “China-Central Asia-West Asia,” covering several countries and potentially encompassing the Transport Corridor Europe Caucasus Asia (TRACECA), connecting China, Kazakhstan, Azerbaijan, Georgia and Turkey, and ultimately Europe by railway.

This corridor presents numerous opportunities for the SC region; however, there are a number of obstacles to be

overcome. Apart from the need to modernize and develop hard infrastructure, a range of challenges come from a lack of soft infrastructure tools. For instance, while examining the efficacy of the road connection between Xinjiang province in China to the port of Poti in Georgia, going through Kazakhstan and Azerbaijan (part of the Trans-Caspian International Transport Route [TITR]), it was revealed that railway cargo loaded in China on 29 January 2015 arrived in Georgia on 6 February 2015. The analysis showed that usually almost a third of the transit time was spent undergoing bureaucratic procedures (Grey 2015). Moreover, the corridor is facing competition from other major corridors connecting hinterland China with Europe, such as the Trans-Siberian and Central Kazakhstan corridors. Therefore, improvements in soft infrastructure across the region will greatly contribute to the increased competitiveness of the corridor passing through the SC region.

Furthermore, the competitiveness of the corridor passing through the SC region is largely linked with Turkey’s historical position as a land bridge between Asia and Europe. To strengthen this connectivity, Turkey has been actively investing in domestic and transnational projects such as the Baku-Tbilisi-Kars (BTK) railway (Reconnecting Asia 2018a). The project began in 2007 with the signing

Figure 6: Turkey’s Vision of Being a Land Bridge between Europe and Asia



Source: CSIS

of an agreement between Turkey, Georgia and Azerbaijan. Azerbaijan is a main investor in this railway scheme and approved a loan of US\$770 million to Georgia for the construction of the missing Akhalkalaki-Kars section and for rehabilitation of the existing route through Georgia.

Despite the Baku-Tbilisi-Kars railway having been completed in 2017, there are still several obstacles to overcome before it becomes fully functional. First, Turkey lacks an effective railway network linking Kars to western Turkey and then on to the EU. In addition, Central Asian and SC countries use a 1.520m gauge, while China, Turkey and EU countries use a 1.435m gauge, known as the standard gauge. Non-harmonized tariff and border-crossing procedures also contribute to increasing costs (Inan & Yayloyan 2018).

In general, Armenia seems to have been left out of the regional mega-infrastructure projects due to its tense relations with Turkey and Azerbaijan. However, the ongoing north-south corridor development, connecting the Indian Ocean and the Persian Gulf to the Black Sea through Iran, Armenia and Georgia, should be noted here. The Chinese Ministry of Commerce has stated that the latter could serve as a key commodities transit corridor, carrying oil from Iran to Europe over Armenia and Georgia and across the Black Sea (MOFCOM 2017). At the same time, Azerbaijan is also making substantial efforts to redirect the north-south corridor in its direction. Accordingly, this proposed US\$3.2

billion link with Armenia is under threat due to the commitment Iran has made to work on the Rasht (Iran)-Astara (Azerbaijan) railway linking the rail networks of Iran, Russia, and Azerbaijan (Inan & Yayloyan 2018). In turn, Baku has offered Iran a US\$500 million loan for the completion of this railway (Valiyev 2016). This line would enable Russian goods to reach the Persian Gulf and, perhaps more importantly, it would facilitate trade between Russia and India via the Indian Ocean.

Ports

Another project that can be related to the BRI in the SC region is the Anaklia Deep-Sea Port (Georgia). Anticipated to serve as the main gateway for imports for approximately 17 million inhabitants of SC and Central Asian countries, it is also expected to provide critical supply routes for nearly 146 million people living within near reach of the port. The ultimate goal is to embrace trade opportunities emerging from the New Silk Road trade route between China and Europe. Set to be operational in 2021 (after the first phase is finished), the US\$2.5 billion project is being constructed in nine phases. The port will be 16 meters deep, thus enabling it to handle various vessel types, such as Panamax, Handymax, and Aframax, with capacities of up to 10,000 TEUs. Phase 1 of the project includes the construction of a container terminal with a capacity of 900,000 TEUs and a dry bulk cargo facility with a capacity of 1.5

Table 5: Summary of Railway-related Projects in the South Caucasus Region

| Initiative/ Project Name | Launch date | Short Description | Financed by | Countries Involved | Status |
|---|-------------|--|-----------------------------|---|----------|
| Baku-Tbilisi-Kars Railway | 2007 | The BTK railway is a regional rail link that connects Kars in northeast Turkey to the Georgian capital of Tbilisi and Baku, Azerbaijan's capital city. Its purpose is to increase the flow of both passenger and freight traffic between all three participating nations, as well as increase political and societal cooperation between them. Experts forecast that the BTK railway line will transport a million passengers and 6.5 million tons of cargo in its initial stage. By 2023, this railway line is forecast to carry an estimated 17 million tons of cargo and about three million passengers. | Azerbaijan, Turkey | Azerbaijan, Georgia, Turkey | Finished |
| Trans-Caspian International Transport Route (TITR) | 2013 | In November 2013, as part of the II International Transport and Logistics Business Forum "New Silk Road" in Astana, the leaders of the JSC "National Company Kazakhstan Temir Zholy," CJSC "Azerbaijan Railways," and JSC "Georgian Railway" signed an agreement on the establishment of the Coordination Committee for the development of the TITR. In December 2016, the participants of the Coordinating Committee for the Development of the TITR—Kazakhstan, Azerbaijan, and Georgia—decided to establish the International Association "Trans-Caspian International Transport Route." Participants predict that the TITR in its initial operations will be able to transport up to 5.5 million tons of cargo annually, rising to 13.5 million tons per year by 2020. | Countries involved via IFIs | Kazakhstan, Azerbaijan, Georgia, Turkey | Ongoing |

Source: Kenderdine (2018), Shahbazov (2017)

Figure 7: Major Ports in the South Caucasus Region

Source: China National Development and Reform Commission

million tons. Its final capacity is expected to reach 100 million tons. The Anaklia Development Consortium, a joint venture between US-based Conti International and Georgia-based TBC Holding, is implementing the project. In addition to the port infrastructure, the consortium is developing a Special Economic Zone in this area. As for the Chinese involvement in this project, it should be noted that due to the limited shipping capacity of the trans-Siberian railway, China is interested in exploring opportunities presented by the Anaklia Deep-Sea Port via the trans-Caspian trade route, especially given the recent completion of the BTK railway. This could explain China's interest in investing in the port. Indeed, Shanghai Zhenhua Heavy Industries

(ZPMC) has committed to investing US\$50 million in the project and to providing the project with various types of equipment needed to control a modern container terminal (Shah 2018).

Another BRI-relevant port, Baku International Sea Trade Port, is currently under construction in Alat settlement. With a total investment of US\$540 million, three phases of construction are anticipated. The first phase aims to bring capacity up to 10 million tons of cargo and 40,000 TEUs, whereas the second stage entails raising this to 17 million tons of cargo and 150,000 TEUs. Once the

Table 6: Summary of Port-related Projects in the South Caucasus Region

| Initiative/Project Name | Launch date | Short Description | Financed by | Countries Involved | Status |
|---|-------------|---|--|--------------------|---------|
| Anaklia Development Consortium (ADC) | 2015 | ADC is developing the Anaklia Deep-Sea Port and the Anaklia City/Special Economic Zone. Anaklia Deep-Sea Port is a greenfield PPP project between Anaklia Development Consortium LLC (ADC) and the Government of Georgia to develop, construct, operate and transfer a deep-sea port on the east coast of the Black Sea. JSC Anaklia City intends to develop the city-scale Special Economic Zone (SEZ) adjacent to Anaklia Deep-Sea Port with about 2,000 hectares of development territory. Development of the port will take place over 9 phases. Phase 1 of construction will be completed in 2021, and the cost of development and construction will be US\$540 million. | Out of a total value of US\$2.5 billion, the Georgian government has offered US\$110 million. The rest has come from the Anaklia Development Consortium LLC. | Georgia | Ongoing |
| Alat Port Azerbaijan | 2013 | The new port in Alat is a transportation hub linking west, south and north. It will also increase Azerbaijan's connectivity as an efficient hub and thus increase the volume of cargo being handled. In addition, the new port's location is linked to existing highways and railways, connecting the port to the inland regions of the country. There are three international rail routes into Azerbaijan, which all converge at Alat: (1) to the northwest, passing through Baku to Russia; (2) to the west, passing through Georgia to the shores of the Black Sea and Turkey; and (3) to the south and to the border with Iran. | Azerbaijan | Azerbaijan | Ongoing |

Source: Shah (2018), Shepard (2016)

third phase has finished, a capacity of up to 25 million tons of cargo and 1 million TEUs is anticipated (Shepard 2016).

Roads and Highways

In terms of road connectivity, it is important to highlight the network of highways crossing the SC region from east to west and south to north. However, many parts of the highways are under construction and still need a significant amount of funding before being completed. In this regard, there are several projects that can be associated with the BRI.

In June 2017, Georgia signed a loan agreement during the second annual meeting of the Board of Governors of the AIIB (a financial institution directly associated with the BRI) for a US\$114 million loan for the construction of approximately 14.3 km of modern highway bypassing the port city of Batumi on the Black Sea coast. This segment is part of the East-West Highway of Georgia (currently under construction) which is connecting the east of the country to the west. Elsewhere on the highway, there is one significant part in the center of the highway around Rikoti mountain pass that still requires significant investment (AIIB 2017). Recently, the Government of Japan devoted US\$340 million to the construction of this part (ADB 2018).

To improve Georgia-Armenia transit options, the Armenia-Georgia Border Road (M6 Vanadzor-Bagratashen)

rehabilitation project has to be noted. The project aims to improve the strategic regional link between Armenia (Vanadzor) and the Georgian border (Bagratashen), one of the busiest roads in Armenia for internal and external trade. The rehabilitation and upgrade of 51.5 km of the two-lane M6 highway from Vanadzor to the border with Georgia at Bagratashen is to be supported by the EIB (US\$56.4 million) and the ADB (US\$50 million) (Reconnecting Asia 2018b).

In addition, the Meghri-Yerevan-Bavra highway, another north-south connection, linking Armenia's southern border with Iran to its northern border with Georgia, financed by the Armenian government as well as through loans from the ADB and the EIB, is seen as a potentially time-efficient route that boosts the Iran-Armenia connection. It takes less time to ship goods from any port in China to Yerevan via the Iranian port of Bandar Abbas than to ship to Georgian ports (Inan & Yayloyan 2018). This corridor, also known as the Persian Gulf-Black Sea Corridor, is a multi-modal transport corridor which envisages connecting Iran with Europe via Armenia and Georgia.

Another corridor is of interest to Azerbaijan. The International South-North Transport Corridor includes India, Iran, Azerbaijan and Russia. This route would enable Indian cargo to head to the port of Bandar Abbas in Iran and then

Table 7: Summary of Road- and Highway-related Projects in the South Caucasus Region

| Initiative/ Project Name | Launch date | Short Description | Financed by | Countries Involved | Status |
|---|----------------|--|--|--|---------|
| Batumi bypass high- way (Georgia) | 2017 | The objective of the Batumi Bypass Road Project is to improve regional connectivity in Georgia and to improve efficiency for road transport along the East-West Highway. The project will construct a new two-lane 14.3 km highway to provide a bypass to Batumi (the second largest city in Georgia). The road would pass through a number of mountainous settlements. Due to the hilly nature of the terrain, this stretch of road requires the construction of five tunnels and 19 bridges over rivers and valleys. | AIIB (36.15%), ADB (36.15%), Georgia (27.7 %) | Georgia | Ongoing |
| Lapis-Lazuli Transport Corridor | 2017 | This corridor aims to enhance regional economic cooperation and connectivity between Afghanistan, Turkmenistan, Azerbaijan, Georgia, and Turkey, and expand economic and cultural links between Europe and Asia. | Afghanistan, Turkmenistan, Azerbaijan, Georgia, and Turkey | Afghanistan, Turkmenistan, Azerbaijan, Georgia, and Turkey | Ongoing |
| Persian Gulf- Black Sea Corridor | 2015 | A multimodal transport corridor which envisages connecting Iran with Europe via Armenia and Georgia. Iran, Armenia, Georgia, Greece, and Bulgaria are key members of the project. One of the key issues in this project is the modernization of transport infrastructure connecting Armenia with Iran and Georgia. | Countries involved via IFIs | Iran, Armenia, Georgia, Greece | Ongoing |
| International North-South Transport Corridor | | The International North-South Transportation Corridor (INSTC) is an India-driven initiative connecting India with Russia and Europe via Iran. This is claimed to be a connectivity initiative parallel to China's One Belt One Road strategy. | Countries involved via IFIs | Azerbaijan, Iran, India, Russia | Ongoing |

Source: Daly (2017), Inan & Yayloyan (2018)

overland by road and/or rail through Azerbaijan and on to Russia and beyond.

Another recent development occurred at the 7th Regional Economic Cooperation Conference on Afghanistan (RECCA-VII) when Turkey, Afghanistan, Turkmenistan, Azerbaijan and Georgia signed an agreement providing for a major international trade and transport corridor stretching from Turkey to Afghanistan via the post-Soviet Central Asian republics, named the “Lapis Lazuli Corridor” (Daly 2017).

3.2. Trade Facilitation: China's Trade Relations in the South Caucasus Region

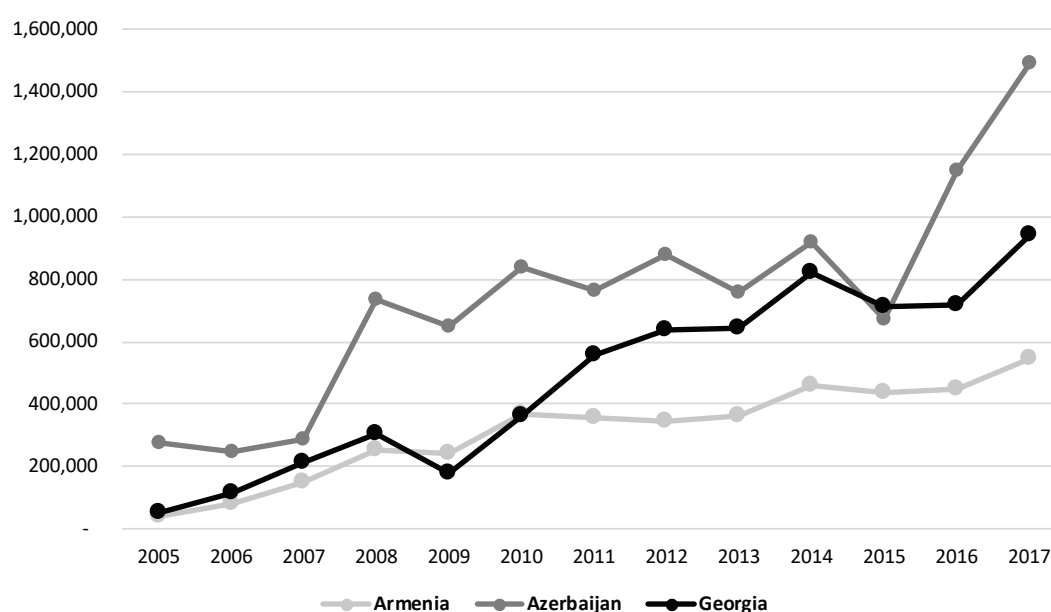
Investment and trade cooperation under the BRI should improve the investment and trade system, and remove investment and trade barriers to enhance business opportunities within the region and for all related countries. In addition, it should ensure that the WTO Trade Facilitation Agreement takes effect and is implemented. It is estimated that in 2020, 80 percent of the world's population will be living in developing countries, many of which are part of the BRI. This section provides an overview of the trading partnerships that SC countries have formed and how each country has seen its trading relationship with China develop.

Armenia and Georgia have been members of the WTO since 2003 and 2000 respectively, while Azerbaijan is still

in the accession process. The trade relationship between Armenia and Azerbaijan is non-existent due to the ongoing conflict, however Georgia enjoys close trade relationships with both countries. As of 2017, Azerbaijan and Armenia ranked 4th and 6th respectively among Georgia's biggest trade partners, while China was 3rd (8.8 percent of total trade turnover). Over the past decade, Georgia has increased its cooperation with China. For instance, bilateral trade between the two countries in 2002 amounted to around US\$10 million, whereas by 2017 it reached US\$940 million. Excluding the EU, China is the third largest export destination for Georgia, accounting for 7.9 percent of total exports (National Statistics Office of Georgia 2017). In 2017, Georgia signed an FTA with China (effective as of 1 January 2018), putting Georgia in a unique position of having an FTA with China and having a DCFTA with the EU.

Similar trends in terms of trade with China have been observed in Azerbaijan and Armenia as well. Azerbaijan's trade turnover with China increased by 30.4 percent to US\$1.49 billion in 2017. Armenia's trade turnover with China is also on the rise: trade between the two countries increased by 21.0 percent in 2017 over 2016 levels. It is also worth mentioning that Armenia is a member of the

Figure 8: Trade Turnover with China (US\$ thousands)



Source: UNCTAD

EAEU, which gives Armenia access to a single economic market of 180 million people (Inan & Yayloyan 2018).

3.3. Financial Integration: FDI in the South Caucasus Region

All three countries in the SC region see FDI as a means of boosting their economies. The chart below shows FDI net inflows as a percentage of GDP for each SC country.

In 2016, Azerbaijan had the largest FDI inflow among the SC countries (see Figure 9). The largest investor in Azerbaijan is the UK, constituting 50 percent of Azerbaijan's FDI inflows between 2003 and 2014 (largely due to investments made by British Petroleum). However, Baku also maintains close ties with Russia, its second-largest FDI investor (UNCTAD 2018b)⁶.

Georgia is also significantly dependent on FDI inflows, which constituted approximately 12 percent of its GDP over the last couple of years. In 2017, the largest investor in Georgia was Azerbaijan (25 percent)⁷ (mainly because of the building of a new pipeline), followed by the Netherlands (19 percent) and the UK (13 percent). China held 10th place with 2 percent. The main investment sectors are transport and communication, energy, real estate and the financial sector. Over the period of 2002-2017, the net inflow of China's investment into the country was US\$590 million

(3.3 percent of total investments over the same period) (GEOSTAT 2018).

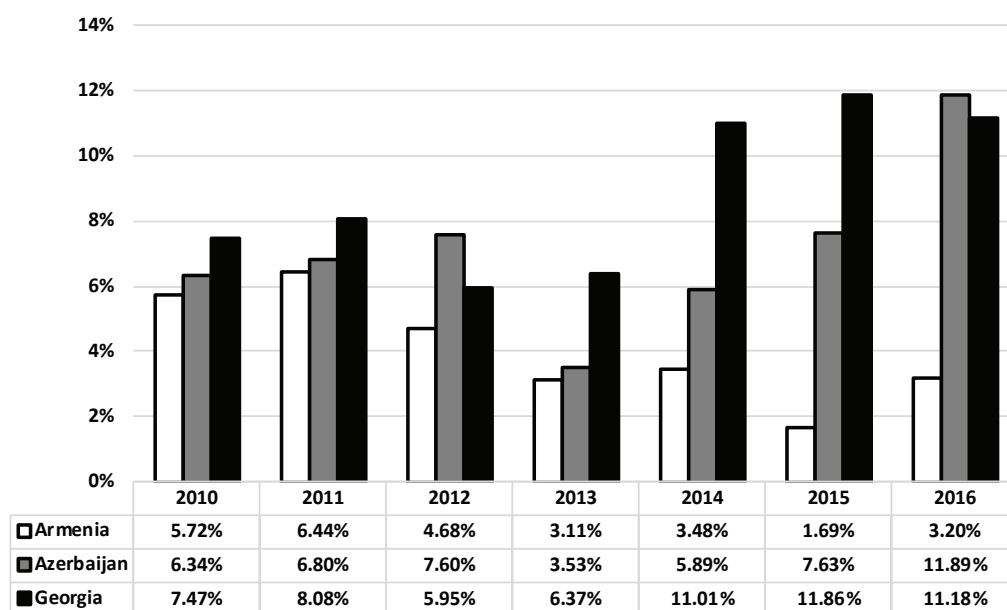
Reportedly, Chinese investments in Georgia target agriculture, banking, telecommunications, infrastructure, hospitality and light industry. Since 2007, the Chinese company Hualing Group has made an approximately US\$500 million investment in Georgia, half of which has been devoted to Free Economic Zones (Tskhovrebova 2016). One such zone is near Kutaisi, which is approximately 120 km from Anaklia Deep-Sea Port. Furthermore, the China Energy Company Limited (CEFC) purchased 75 percent of shares in the Poti Free Industrial Zone located in Poti port (CEFC China 2017).

Armenia has the lowest share of FDI to GDP in the region and has seen no significant investments from China over the course of the last two decades. Armenia's main investor country in 2017 was Germany. In Armenia, Chinese activity is less evident than in the other SC countries. The most notable activity has been China's interest in connecting the Black Sea and the Persian Gulf. In this regard, China Communications Construction Company carried out a feasibility study for the construction of the Southern Armenia Railway project to connect the Black Sea and the Persian Gulf.

Overall, according to World Investment Report 2018 (UNCTAD 2018b), China is becoming an important investor in transition economies (including SC countries). China's

6. Information regarding FDI flows from China to Azerbaijan is not available.
7. Azerbaijan traditionally is one of the largest investors in Georgia.

Figure 9: Foreign Direct Investment (net inflows, percentage of GDP)



FDI stock in this region increased from US\$8 billion in 2011 to US\$23 billion in 2016, making it the fourth-largest investor country for transition economies.

3.4. Policy Coordination

Policy coordination is regarded as an important guarantee of the BRI's implementation, thus this section outlines the extent to which BRI investments are integrated with the national plans of the SC countries' governments.

Georgia

Initially, in 2013, Georgia was not part of the BRI. However, it has gradually become a valuable and reliable partner for China in general. As a result of increased cooperation since 2017, Georgia has repositioned itself, hosted two international forums—one in 2015 and another in 2017—dedicated to the BRI, and signed an FTA with China (Ismalov & Papava 2018).

Currently, the Government of Georgia (GoG) uses two guiding strategy documents to tackle economic challenges. A social and economic development strategy "Georgia 2020," announced in 2012, is a broad guiding document directed at the long-term growth of most economic sectors beyond 2020. Boosting the private sector's competitiveness, developing human capital and improving access to finance are the three main areas on which the document focuses (Government of Georgia 2013). More recently, in 2016, the GoG announced a "4-point plan" focusing on four pillars, one of which is economic development. Both

documents emphasize infrastructure modernization as a key precondition for Georgia to position itself as a transit hub and to unlock trade opportunities. Furthermore, both documents mention Anaklia Deep-Sea Port, the East-West Highway and the BTK railway as pivotal projects in achieving those goals (Gabekhadze 2016).

In terms of advanced manufacturing and transport, in 2016, Georgian Railway signed an agreement with China's CRRC to build a new factory in Tbilisi and to purchase 28 freight locomotives. The agriculture sector has also received attention, as an MoU was signed to support the revival of tea plantations in Georgia. Cooperation in tourism and cultural exchanges have also risen. For instance, talks are ongoing between the two countries about visa-free travel opportunities for tour groups (agenda.ge 2016). The JSC Partnership Fund, a state-owned investment fund, has also established several MoUs, including one with Chinese engineering company SEDIN Engineering Co to assist with the industrialization process (JSC Partnership Fund 2017a). Box 1 below provides more details about JSC Partnership Fund's engagement with Chinese partners.

Furthermore, since 2016, the Georgian Chamber of Commerce and Industry (GCCCI) has been a member of the Silk Road Chamber of International Commerce (SRCIC), a Hong Kong-based entity focusing on the development of

Box 1: JSC Partnership Fund and the BRI

At the Belt and Road Forum for International Cooperation held in Beijing on 14 May 2017, CEFC China Energy Company Limited signed two important cooperation agreements with the GoG: a Memorandum of Understanding on the Joint Establishment of the Georgian Development Bank; and a Strategic Cooperation Framework Agreement on the Joint Establishment of the Georgian National Construction Fund. These documents were signed by Dimitri Kumsishvili, then Georgia's First Deputy Prime Minister and Minister of Economy and Sustainable Development, and David Saganelidze, CEO of the JSC Partnership Fund. The overarching aim of these agreements is to further advance strategic cooperation between CEFC China and the GoG, as well as to build the planned "Silk Road Common Market Zone," which is intended to accelerate the development of an innovative Belt and Road trade model. Furthermore, these agreements state that CEFC China will work with the GoG to set up the Georgian Development Bank. This bank will be controlled and operated by CEFC

China and, in order to boost bilateral economic and financial cooperation, emphasis will be placed on RMB-denominated financial services and cross-border RMB settlement services (CEFC China 2017). Despite having a range of important MoUs, it is worth mentioning that currently there is no single overarching document regarding the BRI, as all of them are project/sector-specific.

Cooperation between the JSC Partnership Fund and Chinese partners goes beyond industrial sectors, as in 2017 the Fund signed a framework agreement with Baima Wine City Industrial Co Ltd to support Georgian wine export to China (JSC Partnership Fund 2017b). This is in line with an increasing trend in wine export. Back in 2016, Georgian Wine House was opened in China, in Jiangxi province (Ministry of Agriculture of Georgia 2016). In 2017, wine exports to China increased by 43 percent over 2016 levels, and according to export data for 2018, after analyzing the first six months, China is the third-largest importer of Georgian wine (data.gov.ge 2018).

the BRI and seeking to advance its members' growth and prosperity by offering trade and investment opportunities.

Azerbaijan

Similar to Georgia, Azerbaijan has a guiding strategy document "Azerbaijan 2020: The Look into the Future," which also presents modernization of transport infrastructure as one of the country's main areas of focus. In order to boost the country's competitiveness in the Europe-Caucasus-Asia and north-south transport corridors, some specific BRI-linked projects have been mentioned, such as an international sea trade port in Alat and the BTK railway (Government of Azerbaijan 2012).

Azerbaijani-Chinese cooperation has been driven by the deepening of economic and trade relations dating back to before the BRI. For instance, in 2005, when Azerbaijani President Ilham Aliyev visited China, an Azerbaijani-Chinese business forum took place with representatives of 40 Azerbaijani and 400 Chinese companies. Among the 20 contracts signed by businesses at the forum, one agreement established a base in Azerbaijan for developing Chinese know-how in the manufacturing of fiberglass cables, mobile drilling rigs used in the oil and gas industry, materials for storage/packaging of agricultural products, and computer technology (Babayan 2014). Ten years later, in 2015 Azerbaijan signed a MoU on construction of the Silk Road Economic Belt, focusing on securing a series of deals in areas including trade, judiciary, civil aviation, education, transportation and energy (Xinhuanet.com 2015).

Armenia

The Armenia Development Strategy for 2014-2025 outlines the general trajectory of Armenia's development vision. However, following the recent political shift in Armenia, the current administration is working on a new strategy document entitled "Armenia Development Strategy 2030" (Government of Armenia 2018).

Currently, compared with the other SC countries, Armenia has the least formalized cooperation with China under the BRI and the developments under this flagship initiative somewhat reflect the general China-Armenia relationship. Moving forward, it will be interesting to follow how cooperation with China will develop under the new administration in Armenia.

4. The BRI and the South Caucasus: Future Outcomes/Potential Impacts

The countries of the SC region have increasingly vulnerable economies due to their high degree of dependence on

certain factors (for instance, Azerbaijan is heavily dependent on oil and gas, Armenia on remittances from Russia, and Georgia on FDI inflows and regional political stability). Thus, for the countries of the SC, the opportunities presented by the BRI could be summed up as follows:

- Diversify economic activities;
- Improve coordination between a wide spread of projects under one umbrella (one aim);
- Enhance regional coordination and utilize the strength of the region to attract more investors; and
- Strive to become more than just transit countries by offering skilled and relatively cheap labor and relatively cheap resources coupled with closer ties with the EU and other markets such as the EAEU.

Due to political tension between Armenia and Azerbaijan, it is not likely that the SC countries will adopt a coordinated policy approach towards the BRI; however, bilateral cooperation (Georgia-Azerbaijan; Georgia-Armenia) has already proven possible.

Among the SC countries, Armenia, having closed border crossings with Azerbaijan and Turkey, should be the most interested in boosting its share of global trade by positioning itself in the BRI. Armenia could leverage its EAEU membership together with closer ties with the EU, Iran and Georgia to transit cargo from south to north. Thus, as part of the BRI, Armenia could consider a south-to-north highway from the Iranian border to the Georgian border as being key for its involvement. Nonetheless, the success of this is likely to be hindered by Azerbaijan's efforts to divert south-north transportation from Iran via Azerbaijan (Inan & Yayloyan 2018).

In terms of future possible impacts, we may consider the corridor approaches and their different stages. Thus, we can assume that the SC region, as a part of the corridors connecting Asia to Europe, will experience varying impacts in terms of integration at various stages.

According to the ADB (2011), the region can be considered as comprising five stages: transport corridor (stage 1), logistics corridor (stage 2), transport and trade facilitation corridor (stage 3), economic or growth corridor (stage 4), and development corridor (stage 5). The countries in this region are at stage one: 'Transport corridors generally refer to the infrastructure dimension that provides physical links to an area in a country or region that previously lacked connection' (ADB 2011).

It could be argued that focusing on soft and hard infrastructure, improved regional ties and communication could serve as a pathway to reach stage five. In this regard, the

BRI could serve as an incentive for SC countries to move forward from stage 1. The journey from stage 1 to stage 5 could bring more cargo and FDI across borders and enable conducive conditions for innovation. As a result, healthier and more developed economies could emerge.

Furthermore, future potential outcomes/impacts could be anticipated by looking at the BRI from a broader regional perspective. According to a recent ADB report, to maintain the regional growth trajectory, eradicate poverty, and respond appropriately to climate change in Asia, infrastructure investments of US\$26 trillion from 2016 to 2030, or US\$1.7 trillion per year, are needed (ADB 2017a). One can argue that the BRI is expected to contribute greatly to narrowing the infrastructure financing gap in Asia. In addition, improved connectivity is expected to enable more favorable conditions for boosting trade. Notably, China and Europe represent the geographic and political ends of the “Belt and Road” for the Eurasian continental part of the initiative, thus BRI-related expectations are linked to their increasing cooperation. Looking at trade between China and Europe, which accelerated after 2001 when China became a member of the WTO, in 2017 it reached US\$573 billion (Fardella & Prodi 2017). In terms of modes of transport, until recently almost 99 percent of the cargo moving from the Asia-Pacific region to Europe and vice versa was transported by sea (European Commission 2018). However, the value of goods shipped by railway increased from €1.6 billion in 2011 to €10.2 billion in 2016 and the value almost doubled from 2015 to 2016, with Germany, Poland and the Czech Republic accounting for 80 percent of total European railway trade with China (source: Eurostat). This analysis is crucial when looking at the possible impacts of the BRI from SC countries’ perspectives, as according to the OECD (2011), in 2050 Europe-Asia railway routes will be able to absorb between 0.5 and 1 million TEUs out of a total of 20 million in the world, or 2.5-5 percent of total shipments. In addition, a simulation by Garcia Herrero & Xu (2016, p. 6) using a gravity model revealed that as far as trade flows between BRI countries are concerned, “a 10 percent reduction in railway, air and maritime costs increases trade by 2 percent, 5.5 percent and 1.1 percent respectively.” Considering the potential benefits of an efficient railway corridor for the BRI, individual countries and corridors are engaged in intense competition.

Development of the information and communication technologies (ICT) and digital technologies sector could be seen as one of the key areas to be indirectly affected by the Initiative. As China has been vocal about building a “Digital Silk Road,” this could also offer potential for the

countries of the SC to engage. For instance, ICT remains one of the fastest-growing sectors in Armenia. According to the Enterprise Incubator Foundation (2015), total revenue from the ICT sector grew by 17.7 percent in 2014, reaching US\$559.1 million in 2015. Furthermore, more than 450 ICT companies operate in Armenia, with average annual growth of 10 percent. However, it should be noted that more skilled human capital is needed. The lack of a skilled workforce is also noted in neighboring Georgia, where there are ongoing capacity building programs funded by the World Bank aimed at the development of an innovation-driven and knowledge-based economy through the advancement of IT skills in Georgia (World Bank 2016). In addition, the existence of fiber optic networks and the affordability of broadband networks and services are extremely important. The Trans-Eurasian Information Super Highway (TASIM) is a fiber-optic route spanning from Hong Kong to Frankfurt in Germany, with an estimated length of 11,000km. This route will pass through China, Kazakhstan, Azerbaijan, Georgia, Turkey and Germany. Currently, the TASIM is still under construction, and its potential to improve ICT connectivity across Eurasia should be noted (ESCAP 2017).

5. Risks along the BRI

Although initially the BRI had been regarded as a domestic development strategy aiming mainly to boost China’s underdeveloped western provinces, gradually it has gained global recognition and is currently viewed as one of the most significant global development initiatives of the 21st century (Szcudlik-Tatar 2013). Risk management, as a key part of economic development, is especially relevant to large-scale infrastructure investments, which are inherently risky due to weak governance or poorly-executed rule of law and corruption. Countries of the SC are not immune to these political, geopolitical, economic, financial, regulatory, social and environmental risks (Sheng 2018). Therefore, this section reviews BRI-related risks relevant to the SC region.

Factors such as political stability, government effectiveness, and rule of law, coupled with democratic accountability and control of corruption, underpin political and geopolitical risks. However, as BRI-related infrastructure projects are interdependent, regional and country-specific internal instability poses a major threat to them. For instance, as noted earlier, the political tension between Armenia and Azerbaijan has been evident in the competition regarding the International North-South Transport Corridor and Persian Gulf-Black Sea routes. Azerbaijan

and Armenia are both seeking improved connectivity with Iran (Sheng 2018). In addition, given Russia's longstanding view of post-Soviet countries as falling within its geographic sphere of influence, China's targeting of the region as a focus of its Silk Road initiative has received a largely negative reaction in the Kremlin (Wilson 2016).

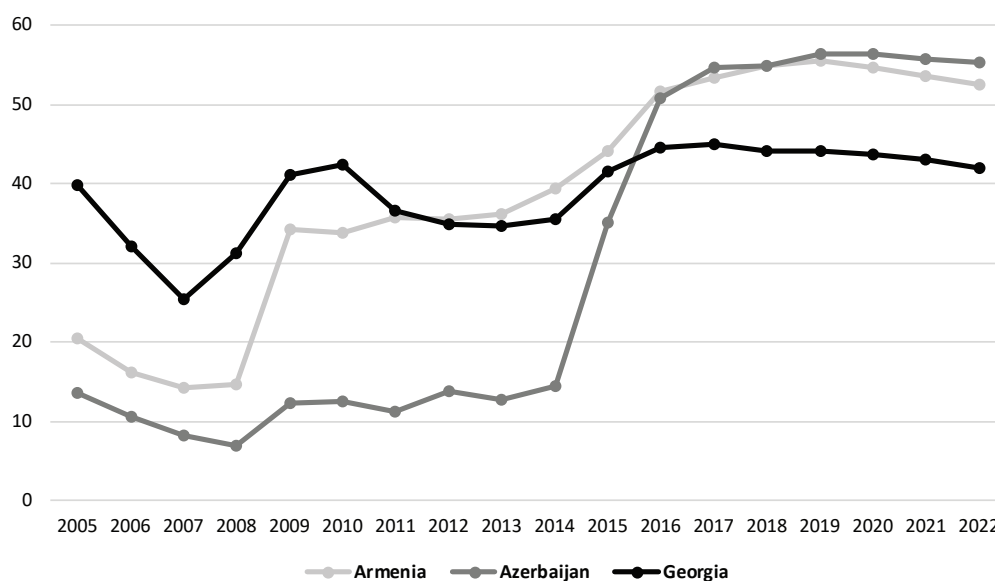
As for the economic and financial risks directly or indirectly threatening the completion of BRI-related projects, many BRI countries adopt foreign exchange control or capital control policies. A paper by the Center for Global Development assessed the likelihood of debt problems in the 68 countries identified as potential BRI borrowers. Eight countries⁸ have been identified as being at particular risk of unsustainable debt based on an identified pipeline of project lending associated with the BRI. Based on analysis of 68 BRI-related countries, the study revealed low, significant and high-risk countries from a debt sustainability perspective. Armenia was found to be at significant risk, while Georgia and Azerbaijan were found to have low debt sustainability (Hurley et al. 2018). It is worth mentioning that increasing debt and China's role in managing bilateral debt problems have already been seen as problematic. For instance, in Sri Lanka, citizens have on a regular basis protested against police over a new industrial zone surrounding Hambantota port. Meanwhile, in Pakistan, Chinese officials

have openly appealed to opposition politicians to embrace the construction of the China-Pakistan Economic Corridor (CPEC), which is among the BRI's flagship projects and has also been the subject of protest (Sheng 2018).

When it comes to the need to increase connectivity in and around the SC region, the need for a significant amount of investment in infrastructure is apparent. Countries in the SC region cannot afford to finance large investment projects by themselves and thus have to borrow. On the one hand, the origin of borrowed money is important (will it be China or other international institutions?), but on the other hand the fiscal space these countries have makes a significant difference. In particular, it is important to assess the risk SC countries are facing by increasing their levels of indebtedness. Figure 10 depicts the current levels of indebtedness for each of the SC countries. Figure 10 shows that external general government debt increased significantly from 2014 to 2016. This is partly caused by the devaluation of the local currencies against major international currencies to which the debt is converted. Since external debt makes up a relatively high share of these countries' debt structures, it caused an increase in the share relative to GDP. According to the IMF, this share should remain relatively stable over the next four years but, as the currency crisis in 2014 showed, these countries should be relatively cautious when considering taking new loans.

8. These countries are Djibouti, the Kyrgyz Republic (Kyrgyzstan), the Lao People's Democratic Republic (Laos), the Maldives, Mongolia, Montenegro, Pakistan, and Tajikistan.

Figure 10: General Government Gross Debt, Percentage of GDP (IMF WEO)



Assessment and management of social and environmental issues can be critical in infrastructure and energy projects and can serve as important drivers of public opinion and attitudes. These issues include, but are not limited to, labor and working conditions, labor strikes, pollution prevention and abatement, demolition and relocation, biodiversity conservation and ecological protection, indigenous people, and cultural heritage (Sheng 2018). The countries of the SC region have different regulatory frameworks handling social and environmental issues related to infrastructure. For instance, in 2018 Georgia adopted the Environmental Assessment Code⁹, including the Environmental Impact Assessment and Environmental Strategic Assessment, whereas Armenia and Azerbaijan rely on international conventions and the internal policies of the funding financial institutions (Parliament of Georgia 2017, United Nations Development Programme 2016). Nonetheless, the enforcement mechanism still needs to be improved. Even before the new legal framework was adopted, the Tbilisi Bypass Railway project¹⁰, led by China Railway 23rd Bureau Group, experienced some challenges. Operating under the 1999 FIDIC Yellow Book conditions, which gives the contractor the right to hire labor according to its own considerations, the company had no obligation to employ a local workforce. Furthermore, some officials from Georgian Railway stated that the style of Chinese management was different from that of Western companies. While the latter concentrate on procedures, careful planning and safety matters, Chinese companies were more concerned with hard results (Zhou 2012). More recently, the same company faced a protest from local Georgian employees working on another railway project in western Georgia. The workforce expressed dissatisfaction with the working conditions and the local population protested against vibrations caused by the construction work, which endangered their houses.

9. This commitment implies adoption of the environmental assessment code that will envisage the requirements of the convention "on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters" (hereafter, Aarhus Convention) in issues of environmental protection and will ensure public participation in the decision-making process in relation with effects on the environment, particularly: to bring potential negative impacts of high-risk activities on the condition of the natural environment, as well as on human life and health, under the environment assessment regulation, in compliance with the requirements of EU directive 2011/92/EC "on the assessment of the effects of certain public and private projects on environment."

10. Construction of the Tbilisi Bypass Railway project started in 2010. Tbilisi has been one of the key junctions within the national and regional junctions; in particular, railway lines leading to Azerbaijan, Armenia and Georgia's Black Sea ports converge in Tbilisi. Due to these major international lines leading to Europe via Turkey, railways in Tbilisi also form part of the east-west transport corridor, which now could be linked to the BRI. Thus, the main reason for this project was to address the growing city's size, population, and traffic flows (Babunashvili 2018).

In terms of dedicated freedom of information legislation, all three countries have provisions in place applicable at the national, regional and local levels. However, the provisions for accessing information vary. Some investment documents, due to their confidentiality, are not open for public viewing. Therefore, it goes without saying that more in-depth and case-by-case research is needed to have more information about the involvement of wide stakeholders into the decisions-making.

From a more global perspective, several studies have been carried out to assess the level of risk associated with BRI-related projects. For instance, the Economist Intelligence Unit (EIU) conducted a study titled "Prospects and Challenges on China's 'the Belt and Road': A risk assessment report." The study is based on risks across 10 categories (security, political stability, government effectiveness, legal and regulatory environment, macroeconomic risks, foreign trade and payment, tax policy, labor market, financial risk, and infrastructure), and revealed that most of the BRI countries have high operational risk (Economist Intelligence Unit 2015). Positively for Georgia, it was given the lowest risk level in the SC region. Another study initiated by ACCA and the Shanghai Stock Exchange (SSE) produced the Belt and Road Country Cooperation Index (BRCCDI). This index is calculated by dividing a country's cooperation level by the level of the operational risk. The average score was set at 1.02, with Kazakhstan and Turkey scoring 1.38 and 1.22 respectively, Georgia scoring 0.88 and Azerbaijan scoring 0.68 (The Association of Chartered Certified Accountants 2017).

6. Recommendations

Based on the analysis, it is clear that the BRI is still unfolding and, due to its scale, it is somewhat chaotic. The main concern related to the BRI is ascertaining the real objectives behind the Initiative. Would investment and trade be driven by market-based transactions, or would they be in the form of foreign aid that is not based on economic calculations of gains and losses? Which of the 65 or so countries in Asia, Europe and Africa along the Belt and Road are likely to be the Initiative's priority targets for economic cooperation? This section provides some recommendations for BRI stakeholders and tries to identify gaps where further research is needed.

6.1. For the Governments of South Caucasus Countries

In general, SC countries should seek better regional coordination (highlighted in more detail in a previous study

by PMCG)¹¹ in order to increase the competitiveness of the trade routes passing through them. The strengths and weaknesses of each corridor need to be examined very carefully. When doing so, focus should be placed on studying already-existing hard infrastructure, its improvement and further steps for improving soft infrastructure in order to increase the competitiveness of the corridors. Countries can use the incentives arising from the BRI to deepen regional economic ties that, in turn, will give the SC region more comparative advantages and allow the region to gain more attention and investments from China. Several particular steps could be helpful here.

Firstly, the simplification of border crossing procedures is of great importance. It is also strongly advised to create a soft infrastructure tool at the regional level, such as a unified tracking and tracing system, while the countries along the corridor should manage an efficient electronic data flow and run scheduled train operations. These steps are all necessary to increase the reliability of the corridor, to significantly reduce the time spent crossing borders, and to minimize cargo delays and theft risk.

Secondly, while investigating the TRACECA corridor, it was identified that tariffs are highly volatile, making it nearly impossible to make any reliable price forecasts. Despite the fact that the parties within TRACECA have signed a number of documents relating to certain benefits and reduced tariffs, in practice little has been accomplished in this direction.

However, as already mentioned above, due to the complex political context and existing regional conflicts, it would be impossible for the countries of the SC to have a joint approach. Therefore, further research is needed to identify regional cooperation options for the countries of the SC. As several BRI-related infrastructure projects have already raised some questions regarding debt sustainability, apart from policy coordination, governments should also be cautious about increasing their debt portfolios.

BRI-related projects have the potential to enable the creation of job opportunities; however, governments should ensure that local human capital development is properly integrated into any such processes.

6.2. For Donors/Investors

In 2016, the net total of official development assistance (ODA) was US\$868 million in the SC region (Georgia, US\$463 million; Armenia, US\$327 million; and Azerbaijan,

US\$78 million) and most of the funding was aimed at social and economic infrastructure (OECD 2018). In addition, major international financial institutions, such as the EBRD¹² and the ADB¹³, have significant portfolios in the region. Having the BRI in the SC region could bring new donors/investors. For instance, Georgia and Azerbaijan have already received loans from the AIIB. The key challenge for donors would be to ensure coordination on a greater scale. Therefore, further research on finding common ground and developing a coordination mechanism would be helpful.

6.3. For Private Entities

Although the BRI is currently a government initiative, its future success depends on interest from the private sector. This has been reflected in a study by Baker McKenzie, in which BRI projects linked to China were assessed to be worth US\$350 billion over the next five years. Most opportunities, as suggested, are unlocked for private companies operating in sectors such as: technology; media and telecommunications; consumer goods and retail; industry; manufacturing and transportation; financial institutions; energy; mining; and infrastructure. In addition, companies providing professional services are critical to mitigate risks, due to the necessity of due diligence, business structuring, contract negotiation, labor and tax regulations, and insurance requirements as part of a firm's successful offshore activities (Baker McKenzie 2017).

However, international companies might face some challenges arising from the lack of knowledge of the local context and the low level of human capacity of the local workforce, as well as complex legal regulations or power structures. Therefore, more insights into the local business environment would be essential for private entities to enter new markets.

In general, it can be argued that there are three main challenges facing the Initiative: selection of appropriate projects; implementation of the projects; and separate political and economic matters. Thus, moving forward it will be important to address the following questions:

- Will the Initiative contribute to stability, or will it fuel power dimensions in countries along the Belt and Road?
- What will the BRI do for regional cooperation and how will it enhance regional connectivity?

11. Zabakhidze, M., and R. Beradze (2017). "Georgia as a Transit Hub and its Increasing Potential in the Implementation of the Belt and Road Initiative." PMCG.

12. Current portfolio in Georgia, Azerbaijan and Armenia as of July 2018 was €789 million, €1,426 million and €312 million, respectively.

13. As of 2016, active portfolio in Georgia, Azerbaijan and Armenia was US\$1,021 million, US\$2,791 million and US\$804 million respectively.

- Will the BRI advance China's soft power and will the BRI give China a greater role in the global governance architecture?
- What will be the role of non-BRI countries in shaping the Initiative?
- What will be the role of new and old financial institutions in the realization of the BRI?

7. Conclusion

This country note has analyzed possible outcomes and impacts of the BRI on the countries of the SC region. Currently, Armenia, Azerbaijan and Georgia are facing socio-economic challenges that can be addressed by infrastructure modernization and enhanced regional cooperation. According to Chinese officials, the BRI is aimed at unlocking new markets, promoting trade, and facilitating investment, consumption, job creation and people-to-people exchange. Therefore, the BRI narrative and the common objectives of the countries of the SC appear to be a natural fit.

Due to the complex political framework and existing regional conflicts, it is impossible for all of the SC countries to have a joint approach. However, Georgia, having good relations with Azerbaijan as well as Armenia, plays an important role in regional cooperation. Thus, bilateral cooperation between countries of the SC has proven possible. The TANAP, for example, showcases cooperation between Georgia and Azerbaijan. The TANAP, combined with the SCP and the Trans-Adriatic Pipeline (TAP), forms the South Natural Gas Corridor that aims to transport gas from Azerbaijan's fields in the Caspian Sea like Shah Deniz II to Turkey and Europe. In a similar manner, the TITR, linking Kazakhstan, Azerbaijan, Georgia and Turkey, and the BTK railway project could also be considered examples of regional cooperation.

Armenia, having just two open borders (one with Georgia and one with Iran), should be particularly interested in boosting its share of global trade by positioning itself in the BRI. Therefore, a south-to-north highway from the Iranian border to the Georgian border can be seen as a key project to ensure its involvement in the BRI. Nonetheless, the success of this is likely to be hindered by Azerbaijan's efforts to divert south-north transportation from Iran via Azerbaijan.

However, while there is some potential to further improve regional connectivity, it should also be mentioned that Georgia, Armenia and Azerbaijan differ greatly in terms of their foreign policies. Georgia, with its NATO and EU aspirations, seeks closer ties with its western allies. Meanwhile, Azerbaijan is trying to keep a balance between

Russia and the West, and Armenia is a member of the Russia-led EAEU. Therefore, given these geopolitical considerations, further research is needed to identify regional cooperation options for the countries of the SC. In addition, as several BRI-related infrastructure projects have already raised some questions regarding debt sustainability, apart from geopolitical peculiarities, governments should also be cautious about increasing their debt portfolios.

In conclusion, the BRI is a priority on the policy agenda of China, with numerous existing and planned projects in and beyond the SC region. However, it is still uncertain as to how this Initiative will be implemented. While synergies could be observed between the BRI and current infrastructure development needs in the countries of the SC region, cooperation is still limited due to a lack of policy coordination, financial risks and concerns about the transparency and fairness of the BRI.

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The Belt and Road Initiative in Central Asia and the South Caucasus: A View from Tajikistan

Rustam Aminjonov and Matin Kholmatov

1. Introduction

In 2013, China announced a new development initiative: the Belt and Road Initiative (BRI)¹, aimed at creating infrastructure and establishing links between the countries of Eurasia (and other continents). The five major goals of the BRI are policy coordination, facilities connectivity, unimpeded trade, financial integration and people-to-people bonds (NDRC et al. 2015).

This year, China celebrates the 40th anniversary of the policy of reform and opening up, as well as the 5th anniversary of the BRI. During the first five years of the BRI, China signed 103 documents on cooperation with 88 countries and organizations. China's total trade with BRI countries exceeded US\$5 trillion. China's total investment in the countries covered by the initiative exceeded US\$70 billion. Chinese enterprises opened 75 zones of trade and economic cooperation that provided 200 thousand new jobs in BRI countries. The volume of trade between the China and Tajikistan increased from US\$2.75 million in 1992 to US\$850 million in 2016, an increase of more than 300 times. Now China has already become the largest source of investment in the economy of Tajikistan, the largest donor country and one of Tajikistan's major trading partners (Avesta 2018).

Between 2007 and 2017, the flow of foreign investment into the economy of the Republic of Tajikistan amounted to US\$8.614 billion, of which US\$3.673 billion was direct investment, US\$4.439 billion other investment² and US\$501.9 million portfolio investment (Table 1).

In 2007-2017, investments from 57 foreign countries were attracted to the economy of Tajikistan. Most of these (US\$2.250 billion, 26.1 percent of the total) came from the PRC.

The main expected result of Tajikistan's participation in the BRI is massive investment from China. It should be noted here that there is no clear and formal distinction between BRI investment/projects and other Chinese

investments in Tajikistan. Starting in 2015 (after the signing of the Memorandum of Understanding between the Ministry of Economic Development and Trade of Tajikistan and the Ministry of Commerce of the PRC on the joint promotion and establishment of the Silk Road Economic Belt), Chinese authorities has considered all their projects in Tajikistan as BRI projects. But the Government of Tajikistan considers such projects as national development projects, which it is implementing with the help of Chinese investments. The case of Tajikistan is not unique, and many experts and analysts note the same phenomena elsewhere:

"There is no agreed-upon definition for what qualifies as a BRI project. Temporally, functionally, and geographically, what counts as a BRI project is open to interpretation. The BRI banner hangs over a wide and ever-expanding list of activities. There are BRI fashion shows, concerts, and art exhibits. By design, the BRI is more a loose brand than a program with strict criteria" (Hillman 2018a).

"The BRI is also breathtakingly ambiguous. There is no official definition for what qualifies as a BRI project. There are Chinese-funded projects in countries not participating in the BRI that share many of the same characteristics. The

Table 1: Foreign Investment in the Tajik Economy, 2007-2017

| Year | Attraction of investments | | | Total, US\$ millions |
|--------------|---------------------------|----------------|--------------|----------------------|
| | Direct | Other | Portfolio | |
| 2007 | 388.4 | 472.2 | | 860.6 |
| 2008 | 425.7 | 563.6 | | 989.3 |
| 2009 | 89.4 | 293.8 | | 383.2 |
| 2010 | 238.9 | 228.2 | | 467.1 |
| 2011 | 161.4 | 164.0 | 0.1 | 325.5 |
| 2012 | 391.3 | 355.0 | 0.1 | 746.4 |
| 2013 | 341.1 | 670.6 | 0.2 | 1,011.9 |
| 2014 | 377.4 | 530.4 | 1.4 | 909.2 |
| 2015 | 470.9 | 506.9 | 0.0 | 977.8 |
| 2016 | 434.2 | 408.4 | 0.1 | 842.7 |
| 2017 | 354.5 | 245.9 | 500.0 | 1,100.4 |
| Total | 3,673.2 | 4,439.0 | 501.9 | 8,614.1 |

Source: Agency for Statistics under the President of the Republic of Tajikistan

1. The BRI's earlier name was the One Belt, One Road (OBOR) Initiative.
2. "Other investments" include soft loans and other financial resources.

BRI was officially launched in 2013, but projects started years earlier are often counted” (Hillman 2018b).

“Association with BRI is equally lithe. Projects and routes that long predate BRI have been brought under the initiative’s umbrella, and companies in China readily identify with BRI, as if it were a kind of franchise. Even the project’s name in English has remained fluid, changing from ‘Silk Roads’, to ‘One Belt, One Road’, and becoming the ‘Belt Road Initiative’ in 2015” (Mardell 2017).

2. Key Characteristics of BRI Engagement in Tajikistan

The Government of Tajikistan counts on the BRI as one of the significant sources of financing for the implementation of the National Development Strategy until 2030 (NDS-2030), especially for large infrastructure projects such as roads, railways, airports, energy facilities (power plants, power lines), etc. President Xi Jinping himself stated that the BRI is “to complement national development strategies by leveraging policy coordination” (Xinhua 2017a). Currently the authorities of both countries plan, within the framework of the bilateral Intergovernmental Commission for Cooperation, to identify a list of priority projects from NDS-2030, which will be labeled as BRI projects and will be financed from BRI funds (via new or enhanced mechanisms including the Asian Infrastructure Investment Bank [AIIB], the Silk Road Fund, and the New Development Bank [also known as the BRICS bank])³. Therefore, this document presents those areas and sectors which have already attracted Chinese investment or most likely will be potential areas for BRI-related projects with Chinese funding in the future.

As for the areas of Chinese investment in Tajikistan, they are mostly chosen by China in its role of investor (“He who pays the piper, calls the tune”). The main areas at the moment are: mining (development of gold, silver, rare earth metals, coal, etc.), construction (cement and brick factories, contracts for the construction of large government facilities), transport (construction and rehabilitation of roads, tunnels and etc.), energy (construction of generating facilities and power lines) and agriculture.

However, it should be noted that virtually all funds (loans and investments) provided by China go to implementing projects defined as priority investments under the National Development Strategy of Tajikistan until 2030 (NDS-2030), which outlines the following key objectives for the next 15 years: 1) ensuring energy security and efficient use of electricity; 2) ensuring better transportation/communication routes to enable the country get out of

the communication deadlock and help transform country into a viable transit country; 3) ensuring food security and public access to quality nutrition; and 4) expanding productive employment. According to NDS-2030, at the first stage of its implementation (until 2020) “the mining industry, energy, transport, telecommunications, food and light industry, building materials industry, tourism, and the financial sector should be developed.” Projects implemented with Chinese investment are also closely integrated with plans and priorities within regional organizations and programs, such as the Shanghai Cooperation Organization, the Central Asia Regional Economic Cooperation (CAREC) Program, etc.

The Belt and Road Initiative and new business modes will further promote economic ties among members of the Shanghai Cooperation Organization, which are deploying more resources in railways, trade, financial services and people-to-people exchanges. New opportunities will come from the growing demand of countries in Central Asia for infrastructure projects and their developing priorities on sustainable development in urbanization and industrialization, and in the service and communication sectors (State Council 2018).

With regard to investment programming and budgeting in Tajikistan, the most recent detailed analysis was carried out in 2013-14 by the World Bank under the Public Expenditure Review (PER-2) and consisted of three stand-alone notes covering the following topics: key issues in the field public finance management, fiscal risks associated with state-owned enterprises, and capital expenditures and public investment management (World Bank 2014). In particular, it noted:

- The Public Investment Program in Tajikistan accounted between 40 to 50 percent of the consolidated state budget. At the same time, investment budgeting in Tajikistan continued to lag international best practice;
- Summarizing the main shortcomings of investment programming in the country, it is necessary to note the abundance of strategic documents, weak coordination between them and the parallel process of budgeting (such as the government making decisions on new investment projects without taking into account the budget process and assessing the financial capacity of the state budget);
- Future operational costs (for maintenance and operation) resulting from investment projects are not well calculated and budgeted for in the preparation of the future budget;

3. Private meetings with senior government officials.

- At the sectoral level, current and capital budgets continue to be prepared separately, often by two different departments (the Budget and Construction Departments), with low levels of coordination and integration between key players;
- To date, there is no system of intermediate and final evaluation of investment projects in Tajikistan, therefore economic efficiency and efficiency of investment projects as cost savings are not assessed (Ecorys 2014).

It should be noted that in the preparation of investment projects with Chinese investment, the necessary consultations with potentially affected communities and the population are usually not conducted, or they are conducted for show. In the case of projects of international financial institutions, such consultations are among the key requirements and usually are paid for as part of the expense of the grants they allocate.

In the beginning, the first Chinese investments were positively received in Tajikistan, as they were aimed at solving the most urgent problems of the country, for which

other donors did not allocate funds for a long time. These investments had a real positive impact on the lives of many people. However, at present the period of euphoria regarding investments from China has passed: first, after 15 years of project implementation, their consequences, positive as well as negative, are fully visible; second, the majority of the working-age population of the country consists of young and mobile people who travel, see, communicate, and read a lot, so they learn about the actual results and consequences of the implementation of projects within the framework of the BRI in the region and around the world. As a result, people are increasingly expressing their indignation and discontent. The BRI is regarded as a “debt trap” in which investments act as a bait and will have to be paid for by real assets (lands, valuable natural resource deposits, operating and new enterprises, infrastructure facilities, etc.) (Sattori 2013). There are grounds for such thoughts—some of them are given in Box 1.

For quite some time now, both local and foreign experts have been trying to bring the issue of discrepancies between the real and declared goals of the BRI to

Box 1: Assets for Debt

In the Tajik capital of Dushanbe, the Chinese company TBEA (Tebian Electric Apparatus) built the Dushanbe-2 thermal power plant. It costed around \$350 million, of which \$330 million was invested by TBEA. In return, TBEA obtained a license to develop two gold-bearing deposits in the Sughd region (Verkhniy Kumarg and Duoba) with proven reserves of about 100 tonnes of gold. The Main Department of Geology under the Government of Tajikistan states that the Company will mine gold in the fields until full compensation of the funds invested in the construction of the Dushanbe-2 thermal power station is achieved. After the compensation of this debt, a new agreement will be signed on new terms.

According to the IMF, Sri Lanka's foreign debt at the end of 2017 amounted to \$48.3 billion, or more than 80 percent of GDP. China's share was approximately \$8 billion. However, according to the New York Times, the Sri Lankan authorities were unable to repay the debt on time and as a result handed over the port of Hambantota to the Chinese state-owned enterprise China Merchants Port Holdings on a 99-year lease. Hambantota is a deep-sea port located at the very crossroads of global trade routes that cross the Indian Ocean. It is noted that Hambantota is indispensable for the energy security of the PRC, because two-thirds of China's imported oil passes along the routes near this port.

According to CNN, China plans to establish a military presence in the South Pacific region due to loans to the island state of Vanuatu. China has provided a \$270 million loan for the construction of a port on the island of Espirito Santo in Vanuatu, as

well as the implementation of other major projects. As a result, China's naval base may appear on the island. At the moment, China already has one foreign base in Djibouti in the Horn of Africa, next to an important transport artery between Asia and Europe. As the Asia Times notes, China's military presence in the East African state was achieved through loans, which reached half of Djibouti's GDP, while China's share in Djibouti's public debt is about 90 percent.

In 2015, the government of Pakistan transferred the port of Gwadar to Chinese state-owned company China Overseas Port Holding on a 43-year lease and allowed the lessee to create a “special” economic zone at the port, writes Asia Times. It is noted that Islamabad borrowed almost \$16 billion from Beijing. As part of a long-term deal, China will receive 91 percent of the profits from the port's revenues and 85 percent of the surrounding zone. Gwadar is the southern end of the China-Pakistan Economic Corridor (CPEC), which originates in the Xinjiang Uygur Autonomous Region of the PRC. Estimated at \$46 billion, CPEC will link China to the Middle East, which is rich in energy resources. The corridor will become an alternative to the Straits of Malacca, through which currently more than 80 percent of China's oil imports pass.

In October 2016, China forgave Cambodia's debt of \$90 million in exchange for concluding 31 new agreements. This allowed the country to take on new loans for a number of projects that will be implemented by Chinese companies. According to the IMF, at that time, China accounted for 43 percent of Cambodia's total debt.

the attention of a wider audience. For example, Pantucci argues that there is a persistent sense among experts and officials in Central Asia that China's interests and investments in the region mask some sort of hidden agenda (Pantucci 2016). The BRI has been presented as free from geopolitical, ideological or military objectives. Beijing insists that the BRI will promote free trade and bring tremendous economic opportunities to all countries along its routes, that there is no "political agenda" behind BRI, and that the initiative's intended result is a "big family of harmonious coexistence" (Xinhua 2017a). Yet not everyone agrees with this common Chinese narrative, and observers perceive the Chinese project with varying degrees of enthusiasm and caution. The most vocal critic of the BRI is India, with Prime Minister Modi accusing Beijing of trying to "undermine the sovereignty of other nations" (Mitra 2017).

Behind the rhetoric of cooperation and mutual benefit are widespread worries about the risks of the BRI, including its effects on employment and the viability of local and national businesses (Leach 2017). Chinese officials are quick to rebut these accusations, as argued in a commentary from the official news agency Xinhua (2017b). And President Xi himself has stated that the BRI is "not meant to reinvent the wheel but to complement national development strategies by leveraging policy coordination."

In January 2018, credit rating agency Fitch published a report on the BRI that questioned the real intentions behind it. The agency stated that the proposal is "driven primarily by China's efforts to extend its global influence," and that "genuine infrastructure needs and commercial logic might be secondary to political motivations" (Fitch 2017). According to unofficial communications of Chinese officials, for achieving the goals of the initiative they expect to lose 30 percent of their investments in Central Asia and up to 80 percent of their money in Pakistan.

Another goal of the BRI is the internationalization of the currency of China, the yuan. There are plans to make the Yuan the official currency of BRI operations (Bateman 2018, Chen 2018, Deloitte 2018). Trade flows along the new silk route will be serviced by a financial system based on yuan. The PRC seeks to create a unique financial system that will unite regional development banks and provide for an increase in settlements in national currencies, primarily in yuan (Pale 2015).

In addition, China is creating new courts in Beijing, Xi'an and Shenzhen to resolve disputes that may arise during the implementation of its initiative.

It is important to note that industrial development is not BRI's primary goal. "It is a China-centric trade

infrastructure development initiative based on a pragmatic concept – enhancing and expanding international trade channels predominantly for current and upcoming Chinese surplus outputs. Beijing wants to redirect its surplus savings by investing in OBOR projects and secure existing and new markets for Chinese products while keeping Chinese companies busy implementing the initiative's projects" (Badykova 2017). However, the investments in non-transport areas (construction, agriculture, etc.) could be seen as providing complementary capacity for economic (corridor) development.

In spite of the fact that China participates in almost all regional organizations and programs (SCO, CAREC, SPECA, etc.), implementation of investment projects in the framework of the BRI is carried out exclusively on a bilateral basis. However, the details of the agreements reached bilaterally are usually not disclosed.

3. Benefits and Risks of the BRI for Tajikistan

The potential impact and consequences of Tajikistan's involvement in the BRI are very significant, both positive and negative. We look at eight specific areas in this section.

3.1. Macroeconomic Indicators

Attraction of large investments always positively affects the main macroeconomic indicators (GDP, industrial production, poverty levels, international reserves, salaries, state budget indicators), at least in the short to medium term, with the exception of the indicator of external debt, as investments are provided mainly in the form of soft loans⁴. In the case of Chinese investments, they create an impression of rapid growth of the main macroeconomic indicators. At the same time, Tajikistan's total external debt as of January 1, 2018 amounted to US\$2.9 billion, which is equal to 40.3 percent of the country's GDP⁵. The main creditors of Tajikistan are the Export-Import Bank of China (CHEXIM) (more than US\$1.2 billion), the World Bank (US\$318 million), the Asian Development Bank (US\$278 million), the Islamic Development Bank (US\$112 million), the European Bank for Reconstruction and Development, as well as financial structures of Arab countries. Debt resulting from the sale of government securities on international markets is US\$500 million. Foreign debt servicing, repayment of principal debt and payment of interest in 2017 were US\$147 million. In the current year, taking into account the maintenance of Eurobonds, this figure will amount to

4. Unfortunately, information about the terms of Chinese financing is not publicly available.

5. Data of the Ministry of Finance of the Republic of Tajikistan.

US\$200 million. According to the analysis of the Center for Global Development, eight countries participating in the BRI— Djibouti, Kyrgyzstan, Laos, Maldives, Mongolia, Montenegro, Pakistan and Tajikistan—have become financially vulnerable and run the risk of bankruptcy as a result of future financing for BRI projects (Hurley et al. 2018). The recently updated Debt Sustainability Analysis also notes that the level of debt unsustainability in Tajikistan has increased from moderate to high, as several important indicators have exceeded the estimated thresholds. The latter reflects a decrease in the country's ability to earn foreign currency for servicing its external debt, which began to increase at an accelerated rate (World Bank 2017). The Fitch credit agency warns borrowing countries that BRI loans may “have negative impact on the country's public finance position if debt-servicing from project proceeds becomes a problem” (Fitch 2017).

3.2. Financial Flows and Foreign Direct Investment (FDI)

The traditional sources of investment for the Government of Tajikistan are international financial institutions and large donor countries (USA, Russia, Japan, EU countries). A number of preconditions for reforms, including political ones, accompany the funds they allocate. Funds are allocated for several years, not at once, but as the conditions are met. In addition, it is necessary to follow strict procedures in procurement, targeted spending, monitoring and reporting. By comparison, loans from China are relatively simple and easy for the government. These loans come quickly and at once, and the procedures for using funds and reporting are rather soft. Chinese funds are typically accompanied by low levels of transparency; mining sector monopolization; and poor compliance with social and environmental standards, which often results in environmental degradation, resource over-depletion, and social tensions (Kurbanov 2018, p. 93).

Thanks to this, China managed to become the main creditor of Tajikistan during last decade. This dependence also affects FDI flows: when deciding whether to award contracts for commercially viable projects, Chinese companies enjoy a preferential position. As a result, China already occupies a dominant position: in the implementation of large infrastructure projects in Tajikistan; in the mining, energy, metallurgical and chemical industries, displacing Western (European, American, Canadian), Russian and other companies; and in construction, gradually moving from large government facilities and infrastructure projects to commercial and residential real estate. China's

position is also increasing in agriculture (through leasing large areas of agricultural land for agricultural production), services (restaurants), health (various clinics) and education (study in China).

3.3. Employment and Migration

The results of numerous studies in recent years confirm the general conclusion that tension in the labor-surplus market of Tajikistan is increasing. It is largely restrained only by the absorption of Tajik excess labor by the Russian Federation through labor migration and simplified forms of obtaining citizenship. This situation is the result of the continued stable growth in labor supply (associated with a high birth rate and corresponding population growth) and the lack of an adequate supply of jobs in the country. The population of the country will grow steadily and by 2030 it is projected to reach 11.5 million people⁶. The continued high population growth in Tajikistan will, of course, contribute to an increase in the workforce. Given the limited capacity of the Government to create jobs in the country, the relevance of external labor migration remains high in the short and medium term. Its volume, according to various estimates, accounts for between 800 thousand to 1.2 million people per year, mainly to two countries, Russia and Kazakhstan, which absorb up to 97 percent of Tajik labor migrants.

In this situation, investments from China exert additional pressure on the already difficult employment situation in labor-surplus Tajikistan, since, when providing investment, China always insists on using its own Chinese workforce. Even for jobs for which workers could be hired in the local market, Chinese workers are brought in. According to unofficial data, the number of migrants from the PRC in Tajikistan can reach 150 thousand (Open Asia 2015). Usually Chinese experts and workers speak only Chinese, which creates additional difficulties in the work. They also do not adapt to the local society. This led to the appearance of perceptions among the Tajik population that Chinese employment practices could result in negative social consequences, such as a lack of employment opportunities for Tajik workers, a decrease in the quality of life of the population, the growth of social problems, and the aggravation of crime (Wolters 2018). Such sentiments and conclusions are not unique to Tajikistan and are also found in neighbouring Central Asian countries. According to the results of an anonymous online opinion survey of informed, influential people in Kazakhstan and Kyrgyz Republic regarding perceived risks of increasing Chinese

6. Projections based on the National Development Strategy of Tajikistan until 2030.

investment, the most feared negative impact is the influx of Chinese immigrants: about 80 percent of respondents tend to agree that this constitutes a risk (Jochec & Kyzy 2018). Kyrgyz people also were deeply concerned that “the enormous difference in the size of the two countries and peoples would mean that the Kyrgyz would soon drown in a Chinese sea” (Goble 2011).

The reasons for these negative attitudes toward Chinese migrants can be grouped into two broad categories: the general fear of “China’s demographic expansion” into Central Asia and competition between locals and Chinese migrants for the limited number of jobs in Kazakhstan and Kyrgyzstan, and the bad reputation of Chinese firms (Garibov 2018, p. 146).

A negative public perception of China and Chinese migrants remains one of the important, but under-researched, challenges to be addressed before implementation of BRI-related projects. The issue is complicated by the lack of consistent and comprehensive statistics on Chinese migration, as well as limited access to this information (Garibov 2018, p. 152). Taking into account the imperfections of accounting and statistics in this area, as well as the lack of reliable information and documented evidence for these possible implications, this is certainly an appropriate area for further research.

3.4. Technology and Innovation

Investments are usually accompanied by technology, innovation and know-how. With Chinese investments, Chinese technology is coming. These technologies are not bad and are always relatively cheaper than analogues from other countries. However, here it is necessary to note two points: these technologies are either (i) obsolete or (ii) Chinese replicas (copies) of new technologies from other countries. At the same time, all the documentation accompanying the technology is in Chinese, which is very inconvenient to use, as it certainly implies the participation of Chinese specialists in the future, as this quote vividly demonstrates:

“Instruction manuals written in Chinese, which accompany Chinese equipment, have been translated into what the Tajiks call Chirussian, a sort of incomprehensible mix between Chinese and Russian. It is therefore understandable that Kyrgyz and Tajiks do not want to become hostage to Chinese expertise, tools, and workers currently operating their domestic high-voltage lines. In fact, the Chinese monopolization of technique and instruments helps to cement local fears that China will control the flow of electricity, possibly to the detriment of Central Asian republics,

thus creating a relationship of dependency” (Duarte 2018, p. 19).

It should also be emphasized that China, with its investments, relies mainly on so-called “dirty” technologies (connected with the extraction of raw materials and, at most, their primary processing), and almost never on the newest and most innovative ones. The only exception is in the sphere of telecommunications, but only in order to control local markets and put them in full dependence on Chinese producers and specialists. For example, in Tajikistan, the whole system of telecommunications, including the Dushanbe video surveillance system “Safe City,” is based on the equipment of two Chinese companies, ZTE and HUAWEI.

3.5. Agriculture

Tajikistan is one of the most land-poor countries in Central Asia, as land suitable for cultivation of crops occupies only about 8 percent of the country’s territory. But, despite this, agriculture is the main source of livelihood of approximately 72 percent of Tajikistan’s population, with their incomes directly or indirectly linked to agriculture. The country’s total arable land area is 720.2 thousand hectares, of which 502.8 thousand hectares are irrigated; thus, there are 0.10-0.09 hectares of arable land and 0.06-0.07 hectares of irrigated land per inhabitant⁷. In conditions of demographic growth, when the population grows at an average rate of 2 percent a year, the arable land areas are unfortunately reduced in per capita terms, and the issues of equal and fair distribution of and access to land resources, as well as related water use, are aggravated. Amid these conditions, the transfer of land to Chinese agricultural producers in Tajikistan is increasing. Over the past six years, the area of land leased by Chinese farmers in Tajikistan has increased from 500 to 18 thousand hectares (Karimzod 2018)⁸. This area is larger than the territory of the capital of Tajikistan, Dushanbe, which is 12.7 thousand hectares. This trend is motivated by the fact that local farmers do not have sufficient funds for effective use (to obtain maximum return) of the available land. These cases cause growing concern and, in some instances, discontent among the local population. This situation is being controlled by the authorities for the time being.

As a result of the low purchasing power of the Tajik population overall and of farmers in particular, coupled with an active dumping policy by Chinese seed producers,

7. Data of the State Committee for Land Management and Geodesy of the Republic of Tajikistan

8. No details on the prior use of the lands and their use by Chinese operators is available.

the latter gradually have expanded their share in the seed market of Tajikistan. As a consequence, better quality seeds from other countries and local seeds, specifically designed to fit Tajikistan's climate and agricultural practices, are being replaced by less suitable Chinese seeds. This may negatively impact the changing gene pool of seeds.

It is well known that Chinese technologies in agriculture provide for the widespread use of chemical fertilizers in the cultivation of agricultural products. The result of this can be the destruction of environmentally friendly products, an increase in the incidence rate of health issues, and most importantly the pollution of rivers, water basins, and groundwater as waste from chemicals, fertilizers and GMOs affect rivers and penetrate aquifers. Taking into account that more than half of Central Asian rivers start in the territory of Tajikistan, this may in future cause a large-scale ecological catastrophe in the region.

A review of available research found only one relevant article on Chinese engagement in Tajik agriculture. This paper discusses large- and small-scale Chinese farm enterprises in Tajikistan, in which discussions around China's "global land investments" and the BRI intersect. "Rather than state-led endeavors as is often assumed, the main Chinese actors in Tajik agriculture are capitalist yet partially state-embedded enterprises driven by profit-oriented goals. Chinese farm enterprises tap into specific market demands that are either unanswered or underdeveloped in Tajikistan, or which have emerged due to the growing number of Chinese consumers in Tajikistan. The nature and drivers of Chinese land acquisitions in Tajikistan shed light on the various, sometimes competing, factors driving China's broader foreign "land rush," in Central Asia (and beyond)" (Hofman 2016).

Taking into account the importance of agriculture for the development of Tajikistan, as well as the lack of reliable information, the impact of the BRI on this sector is also an appropriate area for further research.

3.6. Ecology

In recent decades, China has consistently implemented a policy of transferring industries that adversely affect the environment from its territory to neighbouring countries (Roberts (2014). Two examples of this policy are Chinese investments in the Tajik cement and coal sectors. Thanks to Chinese investments in Tajikistan, several large cement plants have been built in recent years, which has helped turn Tajikistan from an importer of cement to an exporter. While this is beneficial from an industrial development point of view, it also results in significant ecological problems for

the country. Also, mainly due to Chinese investments, coal production has been developed rapidly in Tajikistan, and under the coal industry development program, industrial enterprises are transferred to the use of coal. As part of this program, the coal-fired Dushanbe-2 thermal power station was built in Dushanbe with Chinese money. As a consequence, coal production has grown tens of times in recent years: in 2017 Tajikistan produced a record amount of coal—more than 1.7 million tons; this figure was the highest in the history of Tajikistan (even in the times of the Soviet Union, coal production in Tajikistan barely exceeded 300 thousand tons per year)⁹. In 2018, Tajikistan plans to increase its coal production to 2 million tons per year. Coal is used locally at the thermal power station in Dushanbe and at industrial plants; in the last ten years about 200 enterprises have been converted to coal (CEP 2018). The increase in electricity generating capacity from the coal-fired power plant is welcome to meet local power needs, but Tajikistan faces an electricity shortfall only in winter time, which can be solved by energy efficiency/energy saving programs and energy imports from neighbouring countries (Fields et al. 2012). Environmentalists note that one ton of coal used to generate electricity causes environmental damage of around US\$21 a year. Given plans to bring coal production in Tajikistan to 2 million tons, potential environmental costs for Tajikistan could reach US\$42 million a year.

One of the main dangers of coal lies in the fact that during combustion coal dust settles on the glaciers of Tajikistan, accelerating their melting. This will create additional risks for sustainable development and food security in the region, and in the long term will reduce water supply in Central Asia. According to predictive estimates, thousands of small glaciers in Tajikistan may disappear, the country's glaciated area may decrease by 20 percent, and the volume of ice by 25-30 percent (ADB 2011).

In Tajikistan, which does not have its own oil reserves, a large oil refinery is slated to be built with Chinese funds¹⁰. At the same time, Tajikistan has enormous potential for using environmentally friendly renewable energy sources, namely solar energy (Tajikistan enjoys over 300 sunny days per year) and hydropower resources, which form the basis of the country's energy potential¹¹. These areas might be

9. Data of the Ministry of Industry and New Technologies of the Republic of Tajikistan.

10. It will be built by the Chinese company Dong Ying Heli Investment and Development.

11. Tajikistan, whose land area is the world's 85th largest, ranks eighth globally in terms of total potential reserves of hydroelectric resources, worth 527 billion kilowatt hours per year, after China, Russia, USA, Brazil, Democratic Republic of the Congo, India and Canada. In per capita terms and by land area, Tajikistan ranks either first or second in the world.

potential priority directions for future BRI investments in the energy sector of Tajikistan.

All these industries, put into operation with Chinese investments, have a significant negative impact on the ecological situation in Tajikistan. Both official structures (such as the Committee for Environmental Protection under the Government of the Republic of Tajikistan) and NGOs who monitoring the state of the environment in the country note serious deterioration of the air, water, soil, flora and fauna (CEP 2018). They note that at present access to clean air in general corresponds to international standards, but this is achieved, first of all, due to the clean air of mountainous and adjacent territories. At the same time, increasing economic activity (motor transport, construction of thermal power plants operating on coal and mass transfers of enterprises to coal) on the one hand, and non-compliance with environmental measures on the other hand, exacerbate the situation in cities and valley parts of the country.

The main anthropogenic sources of atmospheric air pollution include the mining, chemical, energy, construction materials, and cotton processing industries. They account for about 88 percent of the total GHG emissions in Tajikistan. The most polluting industries (mining and processing, construction materials, non-ferrous metallurgy) grew the fastest (15-40 percent) compared to average growth in industry (15 percent) (UNDP 2012). Massive development of mineral deposits contributed to continued soil erosion that has already led to a decrease in land productivity, an increase in the level of vulnerability of the rural population and an increase in exposure to natural disasters, such as landslides and floods (CEP 2018). Given that China is the main source of investment for the above-mentioned industries, it can be concluded that China's investment in the deterioration of Tajikistan's environment is quite significant.

3.7. Public Administration and Economic Policy

Chinese investments have a strong influence both on public administration in general, and on individual officials and their policies in particular. The lack of a transparent and effective system of procurement and project management in the provision of funds promotes corruption. To gain the favor of decision-makers and encourage them, China uses the practice of grants for so-called "image" projects of the governments of borrowing countries. For example, this year it was announced that China would provide a grant of US\$220 million to Tajikistan for the construction of a new parliament and government complex in Dushanbe (ASIA-Plus 2018b). On October 13, Tajik President Emomali Rahmon and Chinese Premier Li Keqiang signed a

government-to-government agreement on providing this grant to Tajikistan and took part in ceremonies to lay the cornerstones of the new Tajik parliament and government buildings in Dushanbe (ASIA-Plus 2018a).

At the same time, the exact amount of grants provided by China for projects in Tajikistan and other Central Asian countries is unknown.

China is good at exploiting poor governance practices to get the best deal. This is often made possible by the lack of transparency around the deals they are making. For example, there have been suspicions that Tajikistan's 2011 agreement to settle a land demarcation issue with China, in which the latter gained 1,000 square kilometres of Tajik territory, was an "unofficial debt writing-off agreement, although no documentary evidence exists to support this" (Sattori 2013).

The Chinese business philosophy not only exacerbates local problems associated with good governance and accountability, but also strengthens homegrown animosities. The perception that China is contributing, even indirectly, to social injustice, poor governance, and economic challenges can lead in Central Asia to social unrest and violent manifestations of anger against both ruling elites and their Chinese counterparts (Ghiasi & Zhou 2017).

The provided "easy money" contributes to the transformation of the mindset and thinking of decision-makers, accustoming them not to think about the appropriateness of the funds involved, their effective use, their possible consequences and their impact on the sector in question and on the economy as a whole. Ultimately, these individuals cease to adequately perceive the real situation and the ongoing processes. When negotiating with international financial institutions and foreign investors, decision-makers are already openly using this argument: if you do not give us money on our terms, then we will take it from China. As a result, China has consistently turned into a major source of investment, and Tajikistan is becoming increasingly dependent on its "big" neighbour, which may threaten Tajikistan long-term in terms of potential impacts on the country's sovereignty.

3.8. Culture

Select elements of the cultural policy being promoted by the Chinese authorities are also causing growing concern among analysts:

- The whole world was divided into two parts as seen by the Chinese: Central or Middle (mainland China) and the "foreign barbarian periphery" (barbarians, i.e. all non-Chinese people, who were

considered spiritually incomplete and non-cultured). At the same time, China was given a prior right to carry ultimate power and authority over all other states and people and exhibit the only “right and true order” (Kamornaya 2014). The world order concept as per modern Chinese philosophy has not changed much. Power expansion of Chinese emperors to the outside world is one of the leading mainlines of the traditional political ideology in China (Kamal 2011). As it stands, China considered the territory of Central Asia as “temporarily lost Celestial Empire territories” (Voronov 2018).

- Central Asian countries may be expected to absorb some of China’s excess male population and to assimilate it with the local border population. This is widely practiced in the Xinjiang Uyghur Autonomous Region in China, where an official state assimilation program is in effect for Uyghurs: the state undertakes a mass resettlement of Chinese and encourage marriages between the local and Chinese. For families with children, such incentives are being bolstered if the family is maintained (Kaiman 2014). There is a risk that China may pursue a similar approach among Central Asian countries in the future, along with a conscious effort to dissolve local traditions, rewrite history and shift people’s values.

4. An Overall Assessment of the Impact of the BRI on Tajikistan and Recommendations

There are many benefits for countries affiliated to the BRI, including the possibility of attracting free resources from China to implement large infrastructure projects, the creation of new industries and enterprises, and the opportunity to enter the Chinese market.

Central Asia once played an important role in the old Silk Road, but this region has not appeared on the global stage for several centuries. Since the collapse of the Soviet Union, Central Asian countries have faced tremendous political, economic, and social difficulties. The New Silk Road (BRI) may be the initiative that provides Central Asia with opportunities to actively engage in global trade once again (Jochec & Kyzy 2018).

The BRI has the potential to be a major opportunity for the Central Asian countries to develop physical infrastructure, access new markets via cheaper routes, generate revenues, and strengthen their competitiveness. In the long term, the initiative could transform Central Asia from a landlocked region to a land-bridged region. Tajikistan, as

well as all Central Asian countries, could also enjoy many potential benefits from greater connectivity: trade volumes, growth, reductions in the costs of delivered goods, and firm competitiveness.

As the BRI was only initiated in 2013, it may be too early to assess the likely outcomes of it. To date, there are very few quantitative studies investigating the potential economic impact of this ambitious initiative. One study estimated that improving the transport network and trade facilitation in countries along the BRI route could raise GDP growth in Central, West and South Asia by 0.1 to 0.7 percentage points (Villafuerte et al. 2016). It also suggested that the PRC would gain a lot from the BRI but some countries, such as Mongolia or Pakistan, as well as subregions such as Central Asia and Southeast Asia, stand to benefit significantly as well (Chan 2017).

At the same time, there are significant risks for a small neighboring country like Tajikistan, ranging from economic to social, environmental and political risks, as detailed above. To maximize potential benefits and minimize potential risks, decisive reforms coupled with a strong political commitment are required to overcome vested interests, remove corruption, and liberalize border, trade, and investment policies. This will help to make the region more open to and attractive for foreign and domestic investors, including those from China. It is also important to pursue a more harmonized trade and investment policy within Central Asia, given the high internal barriers imposed as a result of the isolationist policy incentives of local elites (Kurbanov 2018, p. 92).

Below are some recommendations that can help the countries of Central Asia and the South Caucasus in maximizing the benefits and minimizing the risks of the BRI:

4.1. For the Governments of the Countries of Central Asia and the South Caucasus

- Conduct negotiations with China and agree on a clear and mutually acceptable definition of what qualifies as a BRI project.
- Introduce official restrictions on borrowing from China. For example, such borrowing should not exceed 40 percent of the country’s external debt level and 50 percent of the level of attracted FDI. Stop borrowing until the current projects and commitments are fully implemented.
- Conduct a forward-looking labor needs assessment in the country and the region as a whole (e.g. until 2030). Based on this assessment and under the auspices of the BRI, the government can plan

a comprehensive skills training program for the local labor force, taking into account the pipeline of projects to be funded by the BRI.

- Develop and adopt requirements that would allow importation of only new equipment and machinery to Tajikistan/CASC countries (compliant with relevant environmental protection safeguards) and establish a permanent Commission (Working Group) consisting of domestic and international experts (CIS, Europe and Americas) to assess the quality of equipment and machinery being brought into CASC countries under projects funded by China/BRI.
- Revise sanitary safety standards and ban the import, production and use of GMOs in the country.
- Strengthen regional cooperation. Develop a consolidated approach to attracting resources from China and a common strategy and positions for Central Asian countries when negotiating in the framework of BRI projects. China needs this initiative much more than the countries of Central Asia and the South Caucasus; therefore it is necessary to agree on the conditions for attracting borrowing from China so that recipient countries draw overall benefits from the BRI.
- In any case, it would be wise for CASC countries have an alternative plan in case expected BRI goals in the region will not be achieved for whatever reason. At the very least, investment in major infrastructure projects, as well as in industry and agriculture, should be seriously evaluated in terms of their internal potential; first of all, they should make economic sense within a country or region.

4.2. For the International Community

- Significantly intensify its programs and projects in the region. It is possible to develop alternatives to the BRI that would be attractive to the countries of Central Asia and the South Caucasus. A good example might be the Japanese Partnership for Quality Infrastructure in Asia (PQI). The international community needs to more actively and successfully compete with China. Criticism of Chinese initiatives in the absence of alternative proposals and projects sends message to the countries of Central Asia and the South Caucasus that the West pays attention to them only in the context of strategic competition with China.

- Strongly support regional cooperation among the Central Asian countries so that they develop and represent agreed positions during talks with China on BRI projects. Ideally, China and the Central Asian region as a whole should participate in the negotiations over BRI projects, rather than the countries negotiating separately. This would reduce the risk of corruption and abuses in multilateral negotiations.
- International financial institutions should constantly monitor the level of external debt in the countries of Central Asia and the South Caucasus, recommend options for diversification of their loan portfolios and help them avoid excessive borrowing from China.

As concerns future research on the BRI, the following principal questions deserve more attention:

- The overall value of BRI funding in Tajikistan and the financing and other conditions associated with specific BRI projects and programs;
- The impact of the BRI on migration and employment in Tajikistan;
- The impact of the BRI on agriculture in Tajikistan;
- The impact of the BRI on energy in Tajikistan.

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The Belt and Road Initiative in Uzbekistan

Bahodir Ganiev

1. Introduction

Uzbekistan is an important country for China's Belt and Road Initiative (BRI). Situated at the heart of Central Asia, Uzbekistan borders all other Central Asian countries as well as Afghanistan. It has the largest population and the second-largest territory (after Kazakhstan) in the region. It is rich in natural resources such as gas, gold and uranium. It has a relatively well-developed manufacturing base and an extensive network of roads and railways. Several routes of the ancient Silk Road passed through what is now Uzbekistan, with Samarkand, Bukhara and Khiva being major trade hubs along the road.

Uzbekistan has welcomed the BRI. In June 2015, China and Uzbekistan signed an agreement on expanding economic cooperation within the framework of the BRI. The agreement calls for co-building the Silk Road Economic Belt (SREB) through expansion of cooperation between the two countries in trade, investment, finance, transport and communication; implementation of joint infrastructure projects; and collaboration in development of industrial parks (Executive Committee of the Commonwealth of Independent States 2016; Ministry of Commerce of China 2015). Uzbekistan supported the establishment of the Asian Infrastructure Investment Bank and the Silk Road Fund (SRF), which are intended to finance BRI projects. During his visit to China in May 2017, the President of Uzbekistan, Shavkat Mirziyoyev, took part in the high-level roundtable on the BRI and reiterated Uzbekistan's support for the BRI. He stressed the need to fill the concept of the BRI with specific programs and projects, including joint projects in transport, trade, investment, energy and modern technologies (UzDaily.com 2017a). During 2016-2018, Uzbekistan and China signed a number of agreements on collaboration—within the BRI framework—in specific sectors such as transport, trade facilitation, finance, and tourism (China Daily 2017a; Gazeta.uz 2017a). In May 2018, Uzbekistan hosted an international conference on prospects for the implementation of the BRI (Shonazarov 2018).

Uzbekistan has been trying to leverage the BRI to achieve its development objectives. The development priorities of Uzbekistan include upgrading the country's transport and communication infrastructure; improving its transport links with other countries; fully realizing its potential as a transit country for international trade; increasing the production of renewable energy and final goods with high value added; diversifying the direction and composition of exports; developing logistics services, finance, tourism and science; and improving the quality of education (Government of Uzbekistan 2017a). As shown in the appendix below, these priorities closely match the BRI cooperation priorities. Hence, Uzbekistan has tried to attract—within the BRI framework—Chinese financing and know-how into the transport, communication, hydropower and financial sectors; into the petrochemical, textile and food industries; and into tourism, science and education. Uzbekistan has given priority to the development of the East Asia-Central Asia-West Asia transport corridor and the establishment of integrated industrial parks, scientific-innovative clusters and free economic zones along the SREB (Abduvakhitov 2018, Kurbanov 2017, Sayfullin 2017, Shustov 2017, UzDaily.com 2017a).¹

This note provides an overview of BRI projects in Uzbekistan.² In doing so, the note discusses the benefits of BRI projects for Uzbekistan, the risks that the implementation of the BRI poses to the country, and measures that Uzbekistan has taken or needs to take to manage these risks effectively. The note is intended to serve as a background paper for the Emerging Markets Forum (EMF)

1. This paragraph is also based on: Ministry of Foreign Affairs of the Republic of Uzbekistan. International Cooperation. Uzbekistan and the Countries of the World. Cooperation of the Republic of Uzbekistan with the Countries of Asia and the Pacific. <https://mfa.uz/en/cooperation/countries/378/> (accessed 10 September 2018).

2. For the purpose of this note, a BRI project is defined as a project that involves China and is within the BRI framework set out in National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce of the People's Republic of China (2015). The note does not cover the projects that involve China but are deemed to be outside the BRI scope (e.g. the technical assistance that China is providing to the Ministry of Interior of Uzbekistan).

study on the effects of the BRI on the countries of Central Asia and the South Caucasus (CASC).

The rest of the note is organized as follows. Section 2 provides an overview of BRI projects in various sectors of the Uzbek economy. It also discusses the benefits of these projects for Uzbekistan. Section 3 explores major risks that the implementation of the BRI poses to Uzbekistan, factors that exacerbate or mitigate these risks, and measures that Uzbekistan can take to manage these risks more effectively. Section 4 provides concluding remarks.

2. BRI Projects and their Benefits

There are numerous BRI projects in Uzbekistan. While some of them have already been completed, many more are being implemented or considered.³ Using information available in the public domain as of 1 October 2018, this section provides an overview of BRI projects in various sectors of the Uzbek economy.⁴ It also discusses the benefits of these projects for Uzbekistan.

2.1. Rail and Road Transport

Although Uzbekistan considerably improved its transport connectivity with the rest of the world over the past 25 years, its land transport links with East, South and West Asia remain underdeveloped. Uzbekistan needs to develop these links to reduce transport costs and times for international shipments and boost exports of manufactured goods.⁵ Uzbekistan needs to improve its land transport links with East, South and West Asia also to fully realize its potential as a transit country and a logistics hub for trade between East and West Asia, between East and South Asia, and between South Asia and Europe. Therefore, Uzbekistan has been pushing for the construction of the China-Kyrgyz Republic-Uzbekistan and the Mazar-i-Sharif-Herat railways.⁶ Uzbekistan has also been pushing for the

establishment of the Uzbekistan-Turkmenistan-Iran-Oman transport corridor in accordance with the Ashgabat Agreement (Gazeta.uz 2018a, Government of Uzbekistan 2017b).⁷ Simultaneously, Uzbekistan has been improving land transport connectivity between its eastern, western and southern provinces, partly with China's assistance within the BRI framework.

Kamchik Railway Tunnel

The construction of the 19.2 km Kamchik railway tunnel in eastern Uzbekistan is one of the largest completed BRI projects in the country. China Railway Tunnel Group began the construction of the tunnel in September 2013 and completed it several months ahead of schedule in February 2016. The construction cost US\$455 million, of which US\$350 million was financed from a loan provided by the Export-Import Bank of China (Rong 2017, Hui 2018).⁸ About 1200 Chinese workers and over 600 Uzbek workers took part in the construction (Podrobno.uz 2015).

The Kamchik tunnel is a section of the new 124 km Angren-Pap railway, which connects Uzbekistan's three provinces in the Fergana Valley with the rest of the country, bypassing Tajikistan (Figure 1).⁹ The construction of the railway main infrastructure, including the bridges and the single track rail, was completed in 2016. However, electrification of the railway was not completed as of mid-2018. The total cost of the railway, including its electrification but excluding the Kamchik tunnel, is estimated at around US\$1.2 billion. In 2015, the World Bank approved a US\$195 million loan to finance the signaling, electrification of the railway, purchase of track maintenance equipment and technical assistance to Uzbekistan Railways (World Bank 2015).¹⁰

Even without electrification, the railway has substantially reduced the transport costs and times for both passenger and freight rail traffic between the Uzbek part

3. The number of BRI projects being implemented or considered increased markedly after President Mirziyoyev visited China in May 2017. During the visit, China and Uzbekistan signed over 100 agreements envisioning a large number of investment projects worth more than US\$23 billion in total (Gazeta.uz 2017a).

4. The overview may not be comprehensive. While an attempt has been made to cover all major BRI projects on which information was available in the public domain as of 1 October 2018, it is possible that some BRI projects have not been covered due to lack of information or an unintentional omission.

5. At present, transport costs for international shipments to and from Uzbekistan are high, while transport times for such shipments are long and unpredictable. This constrains Uzbekistan's participation in global value chains and partly explains the concentration of its exports in a few primary commodities (ADB 2006).

6. The construction of the China-Kyrgyz Republic-Uzbekistan railway would substantially reduce the railroad distance between Uzbekistan and China, as well as between China and Afghanistan and between China and West Asia. The construction of the Mazar-i-Sharif-Herat railway would establish a railroad link between Uzbekistan and Iran via Afghanistan and shorten the railroad distances between Uzbekistan and Iran's Bandar Abbas and Chabahar seaports, as well as between China and Iran. It would reduce transport costs and transport times and generate transit income

not only for Afghanistan, but also for Uzbekistan.

7. In 2011, Iran, Oman, Qatar, Turkmenistan and Uzbekistan signed an agreement on the establishment of an international transport and transit corridor connecting the signatory countries. The agreement is commonly referred to as the Ashgabat Agreement. Qatar withdrew from the agreement in 2013. Kazakhstan, Pakistan and Iran joined it in 2015, 2016 and 2018, respectively. The implementation of the Ashgabat Agreement would considerably reduce transport costs and transport times for shipments between Uzbekistan and the Arabian Peninsula as well as between Uzbekistan and South Asia. The Uzbekistan-Turkmenistan-Iran-Oman transport corridor could later be connected or even integrated with the East Asia-Central Asia-West Asia transport corridor.

8. No information is available in the public domain about the terms of the loan provided by the Export-Import Bank of China.

9. The old Angren-Pap railway was built during the Soviet Period. It follows a circuitous route around mountains and passes through Tajikistan.

10. Uzbekistan Railways is a state-owned railway company. It built the main infrastructure of the new Angren-Pap railroad, with the exception of the Kamchik tunnel. It is responsible for operating and maintaining the railroad, including the tunnel. It is a profitable company and has a good track record in operating and maintaining railway assets.

Figure 1: Map of New Angren-Pap Railway

Source: CGTN

of the Fergana Valley and the rest of the country. When its electrification is completed, the railway will further reduce transport costs and times. In particular, it will reduce transport costs by about 35 percent for passengers and more than 50 percent for shipments of oil and oil products (World Bank 2018).¹¹ The railway will become part of the East Asia-Central Asia-West Asia transport corridor when the China-Kyrgyz Republic-Uzbekistan railway is built.

China-Kyrgyz Republic-Uzbekistan Railway

China, Kyrgyz Republic and Uzbekistan have conducted several rounds of consultations at various levels and have mostly agreed on the joint construction of the China-Kyrgyz Republic-Uzbekistan railroad. The Shanghai Cooperation Organization (SCO) has expressed support for the project (Podrobno.uz 2018a). The Eurasian Economic Union (EAEU) has indicated that it is willing to co-finance the project (Podrobno.uz 2017).¹² The government of Afghanistan has also expressed support for the project and conducted consultations with the government of Uzbekistan on the joint construction of the Mazar-i-Sharif-Herat railway, which would enable rail shipments between Uzbekistan and Iran through Afghanistan (Podrobno.uz 2018b).¹³

Uzbekistan has started electrification of railways linking Pap with the Kyrgyz Republic (CA-News 2018). UNESCAP has indicated its willingness to help China, Kyrgyz Republic and Uzbekistan draft an intergovernmental agreement on joint use of the China-Kyrgyz Republic-Uzbekistan railway (Podrobno.uz 2018c).

When the China-Kyrgyz Republic-Uzbekistan railway is completed, it will generate many benefits. Notably, it will reduce the transport costs and times not only for shipments between China and the Kyrgyz Republic and between China and Uzbekistan, but also between China, on the one hand, and Tajikistan, Turkmenistan, Afghanistan and West Asia, on the other hand. According to one estimate, the railway will shorten the transport time for rail shipments between China and West Asia by 7-8 days (Podrobno.uz 2017b). Furthermore, the railway will generate transit income for the Kyrgyz Republic and Uzbekistan. It will also foster development of logistics services in these countries in part because various parts of the railway will have different widths and shipments along the railway will involve transshipments.

11. Despite these benefits, it is not clear that its construction would have been justified (given its high cost) if, when the decision to build the railway was taken, relations between Uzbekistan and Tajikistan had been as good as they are now.

12. There is a good deal of complementarity and even overlap between transport and trade facilitation projects within the BRI framework and those supported by the SCO, EAEU and the Central Asia Regional Economic Cooperation (CAREC) Program.

13. The railways connecting Uzbekistan with Mazar-i-Sharif via Hairatan in northern Afghanistan already exist. The former Soviet Union constructed the Termez-Hairatan railroad in 1980s. Afghanistan built the Hairatan-Ma-

zar-i-Sharif railway in 2009-2013, with the assistance of the Asian Development Bank (ADB)—within the framework of the CAREC Program—and participation of Uzbekistan Railways (ADB 2009). Iran is currently building a railroad linking Khaf in eastern Iran with Herat. The construction of this railroad is expected to be completed in 2019 (AzerNews 2018). During their recent visit to Uzbekistan, representatives of Taliban reportedly indicated that they would guarantee the security of the Mazar-i-Sharif-Herat railway (Anhor.uz 2018).

China-Kyrgyz Republic-Uzbekistan Road Corridor

Apart from the China-Kyrgyz Republic-Uzbekistan railway, the East Asia-Central Asia-West Asia transport corridor includes the China-Kyrgyz Republic-Uzbekistan road corridor. This corridor starts in Kashgar in China's Xinjiang Autonomous Region, passes through Osh in southern Kyrgyz Republic and Andijan in eastern Uzbekistan, and ends in Uzbekistan's capital city of Tashkent. Its total length is about 900 km (Yang 2017). Although the roads along the corridor have existed for years, the corridor was not fully operational until recently because Chinese trucks were not allowed to enter Uzbekistan's territory and Uzbek trucks could not enter China's territory.

The corridor became fully operational in early 2018. The China-Uzbekistan road transport agreement that was signed during President Mirziyoyev's visit to China in May 2017 entered into force on 1 January 2018. The agreement has enabled trucks registered in China or Uzbekistan to enter and transit the territory of the other country using special permits issued by Uzbekistan's Agency for Road and River Transport (for Chinese trucks) or China's Ministry of Transport (for Uzbek trucks) (Yue 2018).

The corridor has significantly reduced the transport costs and times for shipments between China and Uzbekistan. The transport costs for cargo shipments between Kashgar and Tashkent along the China-Kyrgyz Republic-Uzbekistan road corridor is about 20 percent lower than the transport costs of shipments by rail via Kazakhstan (Podrobno.uz 2018d). The average transport time for shipments along the China-Kyrgyz Republic-Uzbekistan road corridor is 2 days, as against 8 days for shipments by rail via Kazakhstan (Yue 2018).

The China-Kyrgyz Republic-Uzbekistan road corridor is now being used also for shipments between China and Afghanistan. In mid-2018, Uzbek-Chinese joint venture Silk Road International began transportation of cargo under TIR carnets between China and Afghanistan along the China-Kyrgyz Republic-Uzbekistan corridor and the road connecting Andijan with the Uzbek city of Termez near the Afghan-Uzbek border (Podrobno.uz 2018e). In April 2018, the governments of Uzbekistan and Afghanistan agreed to start multimodal cargo shipments between Afghanistan and China, whereby cargo would be transported by rail between Mazar-i-Sharif (Afghanistan) and Andijan and by road between Andijan and Kashgar. A multimodal logistics center is being built in Andijan to facilitate transshipment of cargo in Andijan (Podrobno.uz 2018f). This route is expected to reduce considerably the transport cost and time for shipments between Afghanistan and China.

Shipments along the route will create jobs in Uzbekistan and generate transit income for the country.

To maximize the benefits of the China-Kyrgyz Republic-Uzbekistan-Afghanistan road corridor, it is important to keep the roads along the corridor in good condition. Unfortunately, roads in Uzbekistan are generally not well maintained for a variety of reasons, including insufficient financing and the low quality of maintenance services. It is not clear if Uzbekistan and the neighboring countries have made any special arrangements to ensure that the roads along the China-Kyrgyz Republic-Uzbekistan-Afghanistan road corridor are properly maintained.

2.2. Oil, Gas and Petrochemical Industries

The Central Asia-China gas pipeline is widely considered to be a BRI project even though the construction of the first two lines of the pipeline, Lines A and B, had been completed and the construction of the third line, Line C, had begun before the launch of the BRI.¹⁴ The existing three lines of the pipeline run 1,830 km from Turkmenistan to China through Uzbekistan and Kazakhstan. The combined capacity of the lines is 55 billion cubic meters per annum (Podrobno.uz 2016a). The fourth line, Line D, whose construction started in 2014 and is expected to be completed in 2020, will run 1,000 km from Turkmenistan to China via Uzbekistan, Tajikistan and the Kyrgyz Republic. The capacity of this line will be 30 billion cubic meters per year (ASIA-Plus 2018). While Kazakhstan, Turkmenistan and Uzbekistan supply gas to China through Lines A, B and C, only Turkmen and (possibly) Uzbek gas will be delivered to China via Line D.¹⁵

The Central Asia-China pipeline has enabled Uzbekistan to export natural gas to China, and generates transit income for Uzbekistan. During President Mirziyoyev's visit to China in May 2017, Uzbekistan and China signed a medium-term agreement on supply of natural gas. The agreement stipulates that Uzbekistan will export 10 billion cubic meters of natural gas to China every year during 2018-2020 (UzDaily.com 2017b).¹⁶

Within the BRI framework, China is assisting Uzbekistan in developing its gas fields under production sharing agreements. Notably, New Silk Road Oil & Gas Company,

14. Lines A and B were commissioned in 2009 and 2010, respectively. The construction of line C began in 2012, and the line became operational in 2014.

15. Uzbekneftegaz, a state-owned oil and gas company, operates and maintains the Uzbek parts of the existing three lines of the Central Asia-China pipeline. Most likely, it will also operate and maintain the Uzbek part of Line D. Uzbekneftegaz has a good track record in operating and maintaining gas pipelines.

16. Data on transit income that the pipeline generates for Uzbekistan are not available in the public domain.

which is a joint venture between Uzbekneftegaz and China National Petroleum Corporation (CNPC), is developing three natural gas fields (jointly referred to as Karakul Block) in Bukhara province of Uzbekistan.¹⁷ In late 2017, CNPC announced that the first phase of the development of Karakul Block had almost been completed and New Silk Road Oil & Gas Company would soon begin exporting about 1 billion cubic meters of natural gas per year to China via the Central Asia-China pipeline (South China Morning Post 2017).¹⁸

Uzbekistan and China are implementing or planning to implement several other joint projects in Uzbekistan's oil, gas and petrochemical industries. During President Mirziyoyev's visit to China in May 2017, Uzbekistan and China signed nine agreements relating to these industries (in addition to the medium-term agreement on supply of natural gas). In particular, Uzbekneftegaz and China Development Bank signed an agreement on co-financing a project to produce synthetic liquid fuel, with the total cost of the project estimated at US\$1.2 billion. Uzbekneftegaz and China Development Bank also concluded a framework agreement on co-financing other oil/gas projects worth a total of US\$1.0 billion (Gazeta.uz 2017a). In June 2018, Uzbekneftegaz and the SRF signed a framework agreement whereby the SRF will finance several oil and gas projects in Uzbekistan. The SRF financing will be in US dollars and Chinese yuan (Jia 2018, Ye 2018).¹⁹ These projects will enable Uzbekistan to increase oil and gas output and develop its petrochemical industry.

2.3. Agriculture, Food Industry, Irrigation, and Hydropower Generation

Uzbekistan and China are collaborating in agriculture and the food industry to boost exports of horticultural and food products from Uzbekistan to China and other countries. In May 2017, Uzbekistan and China's quarantine agencies signed a cooperation agreement (UzDaily.com. 2017a). In April 2018, the agencies held consultations on the establishment of a joint laboratory and a green corridor for exports of horticulture and food products from Uzbekistan to China (Gazeta.uz. 2018b). In September 2018, Uzbekistan and China signed a memorandum of understanding on cooperation in tea production. Bay Tea Group will be Uzbekistan's strategic partner in this area.

The production of tea and its exports to Europe is expected to begin after 2020 (Pozrobno.Uz. 2018g).

China is helping Uzbekistan to modernize its irrigation system and increase hydropower generation. During President Mirziyoyev's visit to China in May 2017, the countries concluded several agreements in these areas. In the agreements, the Chinese entities made commitments to provide loans totaling US\$3.0 billion for irrigation and hydropower projects in Uzbekistan. One of these projects is the upgrading of 299 water pumping stations (Gazeta.uz 2017a). The State Committee on Investment of Uzbekistan and the Ministry of Commerce of China signed an agreement on collaboration in construction of small hydropower stations in Uzbekistan. Subsequently, the President of Uzbekistan issued a resolution on the implementation of this agreement. In November 2018, Turonbank of Uzbekistan and the Export-Import Bank of China concluded a loan agreement whereby the Export-Import Bank of China will provide a US\$58.5 million loan to Turonbank. The latter will on-lend this money to Uzbekgidroenergo, the state-owned hydropower company, for the purchase of Chinese equipment for small hydropower stations (Gazeta.uz 2018c).²⁰

2.4. Industrial Parks

Uzbekistan has been keen to cooperate with China in establishing joint industrial parks for the production of high technology goods. One such park was founded within the Jizzak Free Economic Zone (FEZ) in Uzbekistan's Jizzak province in 2013 (Podrobno.uz 2013). Many companies with Chinese investment have been set up in this industrial park. They enjoy significant tax and other privileges (Bobokhonov 2017).²¹ As of mid-2017, Chinese investments in Jizzak FEZ exceeded US\$90 million. They created over 1,300 jobs for Uzbek workers (Shustov 2017). In addition, more than a dozen companies with Chinese investment have been set up in Angren FEZ.²² Chinese investments in industrial parks and FEZs outside of Tashkent will help Uzbekistan expand the production and export of goods

17. CNPC has made a commitment to invest US\$200 million in this project.

18. As of mid-2018, New Silk Road Oil & Gas Company had not yet started exporting gas to China.

19. None of the Uzbek and Chinese entities involved has released information on the terms at which China Development Bank and the SRF will finance the oil, gas and synthetic liquid fuel projects in Uzbekistan.

20. Like roads, irrigation infrastructure and hydropower stations are not well maintained in Uzbekistan. Therefore, there is a high risk that the modernized water pumping stations and the new hydropower stations will not be properly maintained and these BRI projects will increase Uzbekistan's external debt burden without generating adequate returns.

21. As of 21 March 2018, more than 700 companies with Chinese capital, including 80 companies fully owned by Chinese investors, operated in Uzbekistan. In addition, 73 Chinese companies had representative offices in Uzbekistan (Podrobno.uz 2018h). Data on how many of these companies and representative offices are based in Jizzak FEZ are not available in the public domain.

22. Angren Free Economic Zone. Residents of Angren FEZ (accessed 12 September 2018).

with high value added, create jobs, and reduce (with-in-country) regional imbalances in living standards.

2.5. Tourism

Given that the government of Uzbekistan now gives high priority to the development of tourism and that the expansion of international tourism is one of the priorities of the BRI, Uzbekistan and China are trying to increase collaboration in this sector. In June 2018, the National Bank of the Republic of Uzbekistan for Foreign Economic Activity (NBU) and the SRF signed a cooperation agreement to invite Chinese companies to participate in the construction of a cultural tourism complex in Samarkand (Ye 2018).²³ Two months later, the NBU signed a contract with the China Construction Engineering Design Group, whereby the Chinese firm will develop a master plan of Samarkand and design the cultural tourism complex (Podrobno.uz 2018h). In September 2018, the State Committee on Tourism of Uzbekistan, Beijing Jiufang Grand Move Transportation Equipment Company and the German-Chinese Association for Cultural Exchange in Arts and Design signed a framework agreement on collaboration in tourism. The agreement envisages a number of projects in tourism and related transport, including the construction of a railroad for tour trains in Tashkent and Samarkand regions and the construction of hotels along these railroads. The projects will be fully financed through foreign investments (Gazeta.uz 2018d).²⁴ Chinese assistance to Uzbekistan in developing tourism will help Uzbekistan increase tourist arrivals and tourism revenue.

2.6. Finance

Two Uzbek banks have recently signed agreements with Chinese banks, whereby the Chinese banks will extend loans to them for on-lending to Uzbek firms. In April 2018, Asakabank of Uzbekistan and the Industrial and Commercial Bank of China concluded a framework agreement whereby the Industrial and Commercial Bank of China will provide Asakabank with loans for on-lending to small and medium-sized enterprises (SMEs) in Uzbekistan.²⁵ China's Export-Credit Agency Sinosure will guarantee the loans. The loan proceeds will be used to import equipment and services from China (Gazeta.uz 2018e). In June 2018, the NBU and the China Development Bank signed

a loan agreement, whereby the China Development Bank will provide the NBU with a US\$250 million loan. The loan proceeds will be on-lent to Uzbek firms and used to import equipment from China (Gazeta.uz 2018f). Hence, the collaboration between Uzbek and Chinese banks will improve the availability of credit for Uzbek firms (especially SMEs) and enable them to import Chinese equipment.

2.7. Education, Vocational Training, and Science

Uzbekistan and China are implementing a number of education and vocational training projects that fall under the scope of the BRI (though some of them were launched before the BRI). Notably, two Confucius Institutes have been established in Uzbekistan.²⁶ The institutes provide knowledge about China and teach Chinese as a foreign language (Box 1). Furthermore, four Chinese higher educational institutions have begun teaching the Uzbek language and the Center for the Study of Uzbekistan has been set up at Shanghai University (The Times of Central Asia 2018). In May 2017, Uzbekistan and China signed agreements on collaboration in improving the quality of education in Uzbekistan's secondary schools (Gazeta.uz 2017a).

In July 2018, the Uzbek-Chinese Trade Association and Uzbekistan's Center for Training in Basics of Entrepreneurship concluded a five-year cooperation agreement. They agreed to collaboration in providing training in business administration to Uzbek entrepreneurs and attracting Chinese investment and advanced technologies to Uzbekistan. The Uzbek-Chinese Trade Association made a commitment to help the Center for Training in Basics of Entrepreneurship get a grant—within the BRI framework—for training programs in business administration and research on development of entrepreneurship in Uzbekistan (Trend News Agency 2018).

Huawei Technologies Co., Ltd conducted a Huawei Seeds for the Future program in Uzbekistan in 2017. The program aimed to help Uzbekistan's students familiarize themselves with advanced information and communication technology (ICT) and the enterprise culture of Huawei. As per the agreement between Huawei and Tashkent University of Information Technologies (TUIT), the ten best TUIT students were selected to participate in the program. In May 2017, these students attended a two-week training course in China, where they learned Chinese language, culture, calligraphy and traditions. The students also visited the Huawei headquarters, where Huawei staff gave them

23. The complex will include modern hotels, cottages, entertainment and trade establishments. The construction of the complex is to be completed by end- 2019 (Dolukhanov 2018).

24. The cost of and the implementation dates for the projects have not been announced, and it is not clear if the projects will be financed by foreign direct investment or through external borrowing.

25. The amounts and the terms of the loans have not been announced.

26. One of the institutes is located in Tashkent, while the other one is in Samarkand.

Box 1: Confucius Institute in Tashkent

Uzbekistan was the first nation to sign an agreement with China to set up a Confucius Institute. In June 2004, Lanzhou University, in the capital of Gansu province, and the Tashkent State Institute of Oriental Studies signed an agreement to set up the first Confucius Institute in the Uzbek capital, assisted by the China National Office for Teaching Chinese as a Foreign Language.

The institute opened in 2005, and only 30 to 50 students enrolled in the first year. At the time, few Uzbeks knew anything about China, its language and culture, according to Di Xiaoxia, the Chinese director of the Tashkent Confucius Institute. "In the beginning, we had to expend a lot of effort because the Uzbeks had no idea of what we were or what we taught," she said to a correspondent of China Daily. "We had to place a lot of ads and promotions in the community before parents brought their children to the institute."

Now, the situation is vastly different. After 10 years of development, large numbers of Uzbeks attend the Tashkent Confucius Institute, and more than 1,200 students—aged 8 to 60—attend its Chinese classes every year, according to Saodat Nasyrova, the institute's Uzbek director.

Nasyrova visited China as a 17-year-old student of Chinese, and began teaching the language in 2003. She said studying Chinese has become increasingly popular in Central Asia. "The institute moved into a new building in 2016, gaining more classrooms and greater seating capacity. However, many more people are coming to the admissions office than we can accept," she said.

Source: China Daily (2017b)

training in network security, building of 3G and 4G base stations, and other aspects of modern ICT (Huawei 2017).

Uzbekistan and China have recently begun collaborating in science. In 2016, China modernized the main telescope of Maydanak observatory in Uzbekistan's Kashkadarya province and built a solar power station in the observatory to ensure uninterrupted power supply for the telescope (Podrobno.uz. 2016b). In 2017, China and Uzbekistan launched a joint Global Allium Garden (Kunming Center) at Kunming Institute of Botany of the Chinese Academy of Sciences. Co-constructed by Kunming Institute of Botany and the Institute of Botany of Uzbekistan's Academy of Sciences, Kunming Center is the world's first Allium garden. It is intended to collect, conserve and exhibit over 90 percent of the Allium species of the world, including numerous species of onion and garlic (Chinese Academy of Sciences 2017).

3. Risks Posed by the BRI

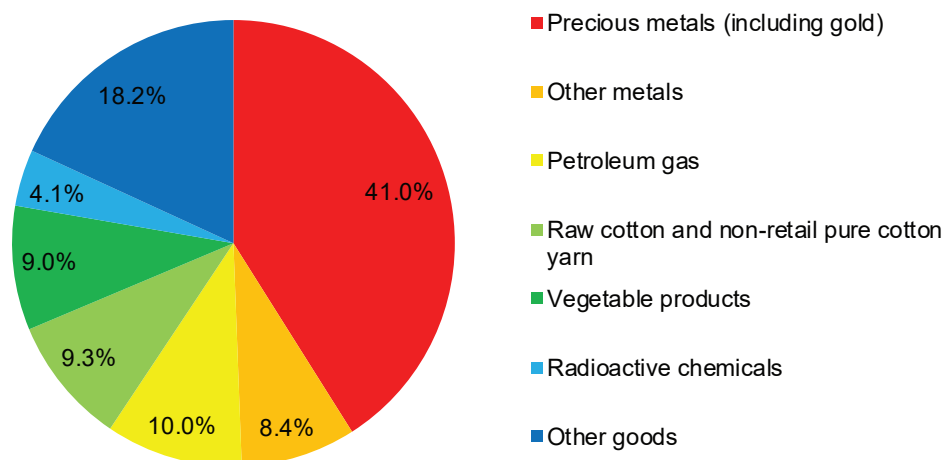
While BRI projects have considerable benefits for Uzbekistan, they also entail certain risks for the country. This section discusses some of these risks, as well as the measures that Uzbekistan has taken, or needs to take, to manage them effectively.

3.1. Risk of Remaining a Supplier of Raw Materials

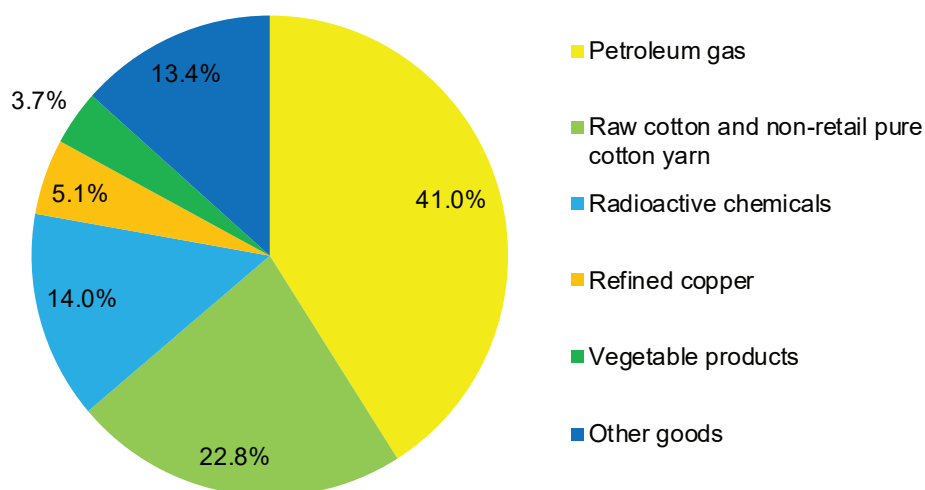
The BRI may perpetuate Uzbekistan's current status of a supplier of raw materials to world markets. Despite its efforts to expand the production and export of goods with high value added, Uzbekistan's exports remain concentrated in raw materials. Primary commodities account for about three-fourths of the country's total merchandise

exports (Figure 2). They also make up the bulk of Uzbekistan's exports to China (Figure 3). There is a risk that the large BRI projects in Uzbekistan's oil and gas sectors (such as the development of new gas fields and the construction of the Central Asia-China gas pipeline) will make it more likely that large proportions of Uzbekistan's scarce resources (such as financial resources and human capital) will continue to be used in the production of primary commodities. This will hinder the development of other industries, and primary commodities will continue to dominate Uzbekistan's exports, including its exports to China. The continued concentration of its exports in primary commodities will keep Uzbekistan vulnerable to the vagaries of world prices for these goods and hinder the country's economic development.

At the same time, the BRI can help Uzbekistan diversify its exports away from primary commodities and towards goods and services with high value added. Indeed, many of the BRI projects reviewed in the previous section serve this purpose. For instance, the BRI projects in the petrochemical and agribusiness industries, as well as those seeking to create industrial parks, will help Uzbekistan attract modern technologies and develop the processing of locally produced raw materials. By reducing transport costs and transport times for international shipments from and to Uzbekistan, the BRI projects in rail and road transport will help the country integrate into global value chains and increase exports of manufactured products. By helping Uzbekistan develop human capital, the BRI projects in education will help the country boost exports of skilled labor-intensive goods and services.

Figure 2: Commodity Composition of Uzbekistan's Merchandise Exports, 2016

Source: Observatory of Economic Complexity

Figure 3: Commodity Composition of Uzbekistan's Merchandise Exports to China, 2016

Source: Observatory of Economic Complexity

To take advantage of the opportunities created by the BRI for boosting exports of goods and services with high value added, Uzbekistan needs to implement a broad range of economic and institutional reforms. Notably, the country needs to improve governance (including the protection of property rights), the quality of health care and education, and the efficiency of labor markets. It also needs to further liberalize foreign trade, restructure state-owned enterprises, curtail state intervention in economic activity, modernize the tax system and customs administration,

enhance market competition, and develop the financial sector. More broadly, Uzbekistan needs to build human capital and create an enabling environment for the private sector to utilize this capital efficiently.

3.2. Risk of Becoming Over-Connected to China

There is a risk that the BRI will make Uzbekistan over-connected to China in terms of trade and capital inflows. China is already Uzbekistan's top trading partner. According to the IMF's Direction of Trade Statistics, China

accounted for 20.2 percent of Uzbekistan's merchandise trade in 2017, compared with 1.2 percent in 2000 (Table 1). Data from other sources (such as the Observatory of Economic Complexity) suggest that China accounts for an even larger proportion of Uzbekistan's trade. China is also one of the top sources of investment inflows to Uzbekistan. As of May 2017, total Chinese investments in Uzbekistan amounted to 7.8 billion (Gazeta.uz 2017a). Inasmuch as BRI projects attract more Chinese investment to Uzbekistan and improve transport links between the two countries, China's share in trade and capital inflows may increase in Uzbekistan. This will make Uzbekistan highly vulnerable to changes in the economic situation in China (e.g., a slowdown in economic growth or an increase in domestic output of goods that China currently imports from Uzbekistan) (Lain 2018).

This risk is mitigated by the fact that Uzbekistan is using the BRI and other mechanisms to expand trade with, and attract investment from, not only China, but also other countries. As mentioned above, Uzbekistan is holding consultations with Afghanistan on the joint construction of the Mazar-i-Sharif-Herat railroad, which would establish a railroad link between Uzbekistan and Iran via Afghanistan, shorten the railway distance between Uzbekistan and Iran's Bandar Abbas and Chabahar seaports, and help Uzbekistan expand trade with Afghanistan and countries of Middle East. BRI projects in agribusiness and industrial parks will help Uzbekistan increase exports of processed

agricultural products and other manufactures not only to China, but also to other countries. Joining the World Trade Organization (WTO), implementing the WTO trade facilitation agreement and improving the business environment more broadly would help Uzbekistan diversify its direction of trade and sources of capital inflows and further mitigate the risk of becoming over-connected to China.

3.3. Risk to Debt Sustainability

At present, Uzbekistan has relatively low stocks of external and public and publicly guaranteed debt. In 2017, the ratio of external debt to gross domestic product (GDP) was 41.3 percent (Table 2). The ratio of public and publicly guaranteed (PPG) external debt to GDP was 24.5 percent, with the government having no outstanding domestic debt. Most of the PPG external debt was on concessional terms. The debt sustainability analysis made by the staffs of the IMF and the World Bank in 2018 concludes that Uzbekistan has a low risk of external debt distress. The analysis assumes modest fiscal deficits and external borrowing over the medium term (IMF 2018). And it does not take into account the government's contingent liabilities.²⁷

However, Uzbekistan's debt burden will increase considerably if the country extensively borrows from China to finance BRI projects and these projects don't lead to

27. A contingent government liability is a fiscal obligation contingent on the occurrence of particular events (e.g. a failure of a state-owned bank or company to service its external debt).

Table 1: Uzbekistan's Merchandise Trade with China, 1995-2017

| | 1995 | 2000 | 2005 | 2010 | 2015 | 2017 |
|-------------------------------|------|------|-------|---------|---------|---------|
| Exports to China | 64.2 | 11.4 | 425.5 | 1,225.7 | 1,195.1 | 1,391.1 |
| In US\$ billions | 0.1 | 0.0 | 0.4 | 1.2 | 1.2 | 1.4 |
| As a % of total exports | 2.4 | 0.5 | 11.5 | 18.2 | 18.4 | 15.3 |
| Imports from China | 52.3 | 41.8 | 244.0 | 1,248.8 | 2,371.1 | 2,932.6 |
| In US\$ billions | 0.1 | 0.0 | 0.2 | 1.2 | 2.4 | 2.9 |
| As a % of total imports | 1.7 | 2.1 | 7.1 | 14.3 | 21.9 | 23.9 |
| Total trade with China | | | | | | |
| In US\$ billions | 0.1 | 0.1 | 0.7 | 2.5 | 3.6 | 4.3 |
| As a % of total trade | 2.0 | 1.2 | 9.4 | 16.0 | 20.6 | 20.2 |

Source: IMF's Direction of Trade Statistics

Table 2: Selected Debt Indicators for Uzbekistan, 2015-2017

| | 2015 | 2016 | 2017 |
|---|------|------|------|
| External debt (% of GDP) | 18.5 | 20.3 | 41.3 |
| of which: Public and publicly guaranteed (PPG) debt (% of GDP) | 9.3 | 20.3 | 24.5 |
| Present value of PPG external debt (% of GDP) | n.a. | n.a. | 19.2 |
| Ratio of external debt service to exports (% of exports of goods and services) | 4.7 | 5.2 | 13.6 |
| Ratio of PPG debt service to government revenue (% of government revenue) | 1.7 | 2 | 3.1 |

Note: The considerable increases in the debt burden indicators in 2016-2017 are due largely to the devaluation of the official exchange rate.

Source: IMF (2018)

commensurate increases in GDP, exports and government revenue. This risk is highlighted by the cases of Tajikistan and other countries whose extensive borrowing from China (in particular, to finance BRI projects) have put their debt sustainability at risk or even caused a debt distress (Jaborov 2018; Hurley, Morris and Portelance 2018, *The Economist* 2018). To avoid such a scenario, Uzbekistan needs to select BRI projects carefully and borrow (preferably on concessional terms) only for those projects for which FDI cannot be attracted and that are likely to increase GDP, exports and government revenue more than the country's external and PPG debt. The government should avoid—as much as possible—incurring contingent liabilities, in particular in connection with BRI projects. The government should also regularly carry out—in collaboration with the IMF and the World Bank—a debt sustainability analysis and publish the results of the analysis together with detailed data on external and PPG debt. The analysis should take into account the government's contingent liabilities. Detailed information about the terms of borrowing from China also needs to be published.

3.4. Governance Risks

Despite the recent progress in institutional reform, corruption remains a serious problem in Uzbekistan. Transparency International ranked Uzbekistan 157th out of 180 countries in its Corruption Perceptions Index 2017 (TI 2018). Uzbekistan's rank in the World Bank's governance indicator for control of corruption was 10.1 in 2016, which means that almost 90 percent of the 209 countries included in the ranking had a better score for control of corruption than Uzbekistan.

There is a high risk that the BRI will create opportunities for rent-seeking and fuel corruption in Uzbekistan. One reason is that the preparation and implementation of BRI projects generally lack transparency and accountability (Jaborov 2018, Lain 2018, *The Economist* 2018, Tian 2018). Another reason is that Uzbekistan's public procurement system has many weaknesses, including inefficient and non-transparent procurement practices; weak capacity for review of bidders' complaints; complicated internal review/approval of bid evaluation reports, leading to low accountability and delays; and low skills/capacity among staff handling public procurement at every level (World Bank 2016). To reduce the risk that the BRI will fuel corruption in Uzbekistan and to ensure that the funds borrowed within the BRI framework are spent efficiently, Uzbekistan needs to strengthen its public procurement system,²⁸

28. The enactment of the law on public procurement in April 2018 is a

make the preparation and implementation of BRI projects (including state procurement under these projects) transparent, and introduce ex-post evaluation of BRI projects. Uzbekistan should also try to involve—as much as possible—international institutions with relatively rigorous project preparation and procurement procedures (e.g. ADB and the World Bank) in the preparation and implementation of BRI projects.

3.5. Environmental Risks

Some BRI projects (such as the construction of pipelines, railways, roads and hydropower stations) may pose serious environmental risks. There is currently little evidence indicating that the environmental risks associated with BRI projects are properly assessed and managed. This may cause problems in the future, as has happened in some other Central Asia countries (Wolters 2018). To mitigate the environmental risks associated with BRI projects, Uzbekistan needs to ensure that the environmental risks of all BRI projects are properly assessed. If an environmental risk of a BRI project is found to be significant, an appropriate risk management plan needs to be developed and implemented. Involving international financial institutions with rigorous environmental safeguards in BRI projects would help identify and manage environmental risks posed by these projects. Enhancing transparency of BRI projects and accountability of all involved parties would also help prevent these projects from causing environmental problems.

3.6. Social Risks

Unlike in Kazakhstan, Kyrgyz Republic and Tajikistan, there has been no public backlash against Chinese investment in Uzbekistan. Indeed, there has been no reason for such a backlash. The number of projects with Chinese investment that have been completed or are being implemented is still quite small. No Chinese investment has had major adverse environmental impacts or necessitated resettlement of a large number of local people. Agricultural land has not been leased, let alone sold, to Chinese farmers, and there have never been plans to do so. The number of Chinese workers in Uzbekistan is small (especially relative to the size of the population).

However, as the number of BRI projects that are completed or are at the implementation stage rises, the risk of popular discontent with the BRI may also rise.²⁹ The risk

major step in the right direction.

29. China's experience of investing in Africa, and, more recently, in Sri Lanka and Thailand, reveals that public protests, anxieties, and expressions of Sinophobia are to be expected in response to rapidly expanding Chinese

may rise considerably if any BRI project causes a major environmental problem, forced resettlement of local people or an influx of Chinese workers. The risk will also rise if the perception spreads that only China and corrupt Uzbek government officials are benefiting from BRI projects, while ordinary people in Uzbekistan are bearing the costs of these projects. To reduce the likelihood that BRI projects will cause popular discontent, the government of Uzbekistan needs to enhance transparency and accountability in the preparation and implementation of BRI projects; ensure that BRI projects are prepared in consultation with key stakeholders (such as local communities and civil society); and encourage Chinese firms involved in the implementation of BRI projects to employ local labor. Cultural and educational exchanges and other forms of “people-to-people” contacts between Uzbekistan and China can also help prevent misunderstandings, misperceptions and popular discontent with BRI projects in Uzbekistan (Dave 2018).

3.7. Security Risks

By improving regional connectivity, the BRI may lead to an increase in transnational crime, such as drug trafficking, terrorism, money laundering and cybercrime. The risk of an increase in drug trafficking is especially high for Uzbekistan, given its proximity to Afghanistan, which is the world’s leading illicit producer of opium (Diener 2015). To manage the security risks effectively, Uzbekistan needs to continue collaborating on security issues with Afghanistan, China and other countries through both bilateral and multilateral mechanisms, such as the SCO.

4. Concluding Remarks

For Uzbekistan, the BRI is a useful framework for bilateral cooperation with China, as well as multilateral cooperation with China and other countries. Taking the advantage of the high degree of congruence between Uzbekistan’s development priorities and the BRI cooperation priorities, Uzbekistan is trying to leverage the BRI to achieve its development objectives. In particular, Uzbekistan is attracting—through BRI projects—Chinese financing and know-how into priority sectors of the economy. Uzbekistan’s case suggests that the countries covered by the BRI can benefit more from the BRI if they have a coherent medium-term development strategy and ensure that their BRI projects are aligned with this strategy.

The number of BRI projects in Uzbekistan increased markedly following President Mirziyoyev’s visit to China

in May 2017. There are now BRI projects (completed or being implemented or considered) in many sectors of the Uzbek economy, including railway transport, energy, petrochemicals, agriculture, food, finance, hotels, education and science. An industrial park and many enterprises with Chinese investment have been established in Uzbekistan within the BRI framework.

BRI projects have many benefits for Uzbekistan. In particular, the BRI projects in transport can help Uzbekistan reduce (within-country) imbalances, integrate into global value chains, boost the production and exports of goods with high value added and diversify the composition and direction of trade by improving transport links among various parts of the country and reducing the transport costs and times for international shipments. These projects can also generate considerable transit income for Uzbekistan and foster the development of logistics services in the country. The BRI projects in the petrochemical, agribusiness and food industries will help Uzbekistan attract modern technologies and develop manufacturing. The BRI projects in irrigation and hydropower generation will help Uzbekistan use its water resources more efficiently, increase power generation and improve the supply of electricity. The BRI projects in tourism will help Uzbekistan increase tourist arrivals and tourism revenue and create many tourism-related jobs. Uzbekistan is closely collaborating not only with China, but also with other countries (e.g. Afghanistan and Kyrgyz Republic) as well as with international organizations (such as ADB and the World Bank) to increase the benefits of the BRI projects. To fully reap the benefits of the BRI projects, Uzbekistan needs to ensure proper operation and maintenance of the infrastructure assets that have been created or upgraded through BRI projects, or are essential for the effectiveness and sustainability of BRI projects.

At the same time, the BRI poses a number of risks for Uzbekistan. To manage these risks effectively, Uzbekistan needs to strengthen its procurement system and debt management; enhance the transparency and accountability of BRI projects; involve—as much as possible—international organizations in the preparation and implementation of BRI projects; introduce ex-ante economic, financial, environmental and social impact assessments and ex-post evaluation of BRI projects; and collaborate more closely with China and other countries in fighting transnational crimes. Implementing further economic and institutional reforms that would reduce corruption, improve the business environment, enhance market competition and increase human capital would not only mitigate some of

investments and China’s role in a country’s economic development (Dave 2018).

the major risks posed by the BRI, but also help maximize the benefits of the BRI.

The following three research questions are proposed for the EMF study on the BRI in CASC:

1. What are the most effective feasible mechanisms for the involvement of international and regional organizations in BRI projects that Uzbekistan and the other countries of CASC could use to increase the benefits of BRI projects and mitigate the risks posed by the BRI?
2. How can Uzbekistan and the other CASC countries use recent advances in ICT and artificial intelligence (e.g. block-chain technology) to get more benefits from the BRI?
3. What are the implications of growing protectionism in the world and the slowdown and rebalancing of growth in China for BRI projects in CASC?

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Annex: Uzbekistan's Development Priorities and BRI Cooperation Priorities

| Uzbekistan's Development Priorities* | BRI Cooperation Priorities** |
|---|--|
| Transport, ICT, Trade, Investment and Manufacturing | |
| Further development of transport infrastructure. | Linking up unconnected road sections, removing transport bottlenecks, advancing road safety facilities and traffic management facilities and equipment, and improving road network connectivity. |
| Further introduction of ICT in the economy, social sphere and public management. | Building a unified coordination mechanism for whole-course transportation, increasing connectivity of customs clearance, reloading and multimodal transport between countries; and gradually formulating compatible and standard transport rules, so as to realize international transport facilitation. |
| Liberalization and facilitation of exports, diversification of the composition and direction of exports, increasing and effective utilization of export potential of various industries and regions. | Advancing the construction of cross-border optical cables and other communications trunk line networks, improving international communications connectivity, and creating an Information Silk Road. |
| Improvement of the investment climate to attract more FDI. | Building bilateral cross-border optical cable networks at a quicker pace and improving spatial (satellite) information passageways to expand information exchanges and cooperation. |
| Establishment of new free economic zones and industrial parks and raising the efficiency of existing ones. | Enhancing customs cooperation such as information exchange, mutual recognition of regulations, and mutual assistance in law enforcement. |
| Introduction of modern technologies and enhancing the competitiveness of locally produced goods in domestic and foreign markets. | Improving bilateral and multilateral cooperation in the fields of inspection and quarantine, certification and accreditation, standard measurement, and statistical information. |
| Further modernization of the industrial sector with accelerated development of high technology manufacturing, in particular the production of goods with high value added through deep processing of local raw materials. | Lowering non-tariff barriers, jointly improving the transparency of technical trade measures, and enhancing trade liberalization and facilitation. |
| Increasing the share of industry, services, and small and medium-sized enterprises in the national economy. | Expanding trading areas, improving trade structure, exploring new growth areas of trade, and promoting trade balance. |
| Reduction of (within-country) regional imbalances in living standards through accelerated development of less-developed regions. | Making innovations in forms of trade, and developing cross-border e-commerce and other modern business models. |
| | Setting up a service trade support system to consolidate and expand conventional trade, and strengthening efforts to develop modern service trade. |
| | Improving investment and trade facilitation, and removing investment and trade barriers for the creation of a sound business environment within the region and in all related countries. |
| | Integrating investment and trade, and promoting trade through investment. |
| | Expanding mutual investment areas. |
| | Promoting cooperation in the processing and conversion of energy and resources at or near places where they are exploited, so as to create an integrated industrial chain of energy and resource cooperation. |
| | Promoting in-depth cooperation in new-generation information technology, biotechnology, new energy technology, new materials and other emerging industries, and establish entrepreneurial and investment cooperation mechanisms. |
| | Working together to build all forms of industrial parks such as overseas economic and trade cooperation zones and cross-border economic cooperation zones, and promote industrial cluster development. |
| | Encouraging the entire industrial chain and related industries to develop in concert; establishing R&D, production and marketing systems; and improving industrial supporting capacity and the overall competitiveness of regional industries. |

* Based on Government of Uzbekistan (2017)

** Based on National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce of the People's Republic of China (2015).

Annex: Uzbekistan's Development Priorities and BRI Cooperation Priorities

| Uzbekistan's Development Priorities* | BRI Cooperation Priorities** |
|--|---|
| Energy | |
| Increased use of renewable energy. | Promoting cooperation in the connectivity of energy infrastructure, building cross-border power supply networks and power-transmission routes, and cooperating in regional power grid upgrading and transformation. |
| Improved provision of electricity to the population. | Advancing cooperation in hydropower, wind power, solar power and other clean, renewable energy sources. |
| Agriculture and Processing of Agricultural Goods | |
| Increased local processing of agricultural products through expansion of food and textile industries. | Deepening cooperation in agriculture, agricultural machinery manufacturing, and farm produce processing. |
| Overall Services Sector | |
| Faster development of the services sector. | Increasing the openness of BRI countries' service industries to each other to accelerate the development of regional service industries. |
| Tourism | |
| Accelerated development of tourism. | Enhancing cooperation in and expanding the scale of tourism; holding tourism promotion weeks and publicity months in each other's countries; jointly creating competitive international tourist routes and products with Silk Road features; and making it more convenient to apply for tourist visas in countries along the Belt and Road. |
| Financial Sector | |
| Safeguarding the soundness and stability of the banking system. | Strengthening financial regulation cooperation, encouraging the signing of MOUs on cooperation in bilateral financial regulation, and establishing an efficient regulation coordination mechanism in the region. |
| Improvement of the availability of credit for investment projects and to small and medium-sized enterprises. | Improving the system of risk response and crisis management, building a regional financial risk early-warning system, and creating an exchange and cooperation mechanism of addressing cross-border risks and crises. |
| Development of the securities stock market. | Increasing cross-border exchange and cooperation between credit investigation regulators, credit investigation institutions and credit rating institutions. |
| Improvement of the quality of existing financial products and introduction of new financial products. | Carrying out multilateral financial cooperation in the form of syndicated loans and bank credit. |
| | Supporting the efforts of governments of the countries along the Belt and Road and their companies and financial institutions with good credit rating to issue Renminbi bonds in China. |
| | Encouraging qualified Chinese financial institutions and companies to issue bonds in both Renminbi and foreign currencies outside China, and use the funds thus collected in countries along the Belt and Road. |
| | Giving full play to the role of the Silk Road Fund and that of sovereign wealth funds of countries along the Belt and Road, and encouraging commercial equity investment funds and private funds to participate in the construction of key BRI projects. |
| Education | |
| Improvement of the quality of and access to education. | Sending more students to each other's countries, and promoting cooperation in jointly running schools. |
| Further development of the system of continuous education. | Integrating existing resources to expand and advance practical cooperation between countries along the Belt and Road on youth employment, entrepreneurship training, vocational skill development, social security management, public administration and management and in other areas of common interest. |
| Training of highly skilled workers to meet the needs of the labor market. | |

* Based on Government of Uzbekistan (2017)

** Based on National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce of the People's Republic of China (2015).

Annex: Uzbekistan's Development Priorities and BRI Cooperation Priorities

| Uzbekistan's Development Priorities* | BRI Cooperation Priorities** |
|--|---|
| Science | |
| Support for scientific and innovative activities. | Increasing cooperation in science and technology, establishing joint labs (or research centers) and international technology transfer centers, promoting sci-tech personnel exchanges, cooperating in tackling key sci-tech problems, and working together to improve sci-tech innovation capability. |
| | Encouraging think tanks in the countries along the Belt and Road to jointly conduct research and hold forums. |
| Protection of Environment | |
| Mitigation of adverse effects of global climate change and the environmental crisis in the Aral Sea basin. | Promoting ecological progress in conducting investment and trade; increasing cooperation in conserving the eco-environment, protecting biodiversity, and tackling climate change. |
| <p>* Based on Government of Uzbekistan (2017)</p> <p>** Based on National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce of the People's Republic of China (2015).</p> | |

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