

# China's Expanding Energy and Geopolitical Linkages with Central Asia and Russia: Implications for Businesses and Governments

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He was later head hunted as Director for British Gas (BG) Group in London, one of the world's largest natural gas and petroleum multinationals, managing high-level government engagements in support of the company's global assets and new business development (2005-2011). He served as the chairman of International Advisory Board for Invensys plc, a FTSE 100 technology company, worked as an independent board member of Yasar Holding Group (major food and beverage conglomerate) and senior advisor to the Saudi Crown Investment Holding.

Mehmet is a graduate of Turkey's "Mulkiye", London School of Economics (MSc) and College d'Europe (MA), Bruges. As an honorary fellow, he teaches occasionally at London School of Economics' Enterprise Executive Programme, Harvard University's Kennedy School of Government, Dundee University, and University of Reading since 2005.



## Abstract

This paper discusses the expanding links between China, Central Asia and Russia over the past quarter a century, most recently via the Belt and Road Initiative (BRI), in geopolitics and trade/investment, as well connections in oil, gas and electricity. These links that continue to expand are likely to change the current economic, political and energy landscape beyond recognition.

They are forging mutual economics dependencies and reducing security risks. The paper also assesses whether, as a result of these developments, Russia's influence in the region's energy and geopolitics will further wane. Finally, it set out what the future has in store for China's Central Asia strategy in terms of both high expectations and tangible results, before concluding on how governments and businesses in the region should position themselves accordingly<sup>1</sup>.

### Silk Road Economic Belt and Maritime Silk Road



Source: Xinhua, 2017

1. The authors are grateful to the D-Group, London, where they recently led a roundtable discussion on Central Asia, as well as to Zeinolla Kalymbetov, Ernest Zhanaev, Gani Abaidildinov and Xu Xiaojie, who kindly provided inputs.



# China's Expanding Energy and Geopolitical Linkages with Central Asia and Russia: Implications for Businesses and Governments

## Central Asia on the move again

Central Asia is no longer a terra incognita, characterised in the early 1990s as the stans<sup>2</sup>, following the disintegration of the Soviet Union. Today, Central Asia is critically important on the world's geopolitical, energy, transportation and «clash of civilisations» chessboard, with substantial deposits of rich natural resources and minerals as an instrument of power and agent of development. It is at the nexus of a number of interlocking regions: Russia and Eurasia, the Middle and Near East, South Asia, and Asia more broadly. Central Asia is simultaneously a buffer zone between conflict areas and a transit area connecting East Asia with Europe and Russia.

It is the core region of the Asian continent, stretching from the Caspian Sea in the west to China in the east and from Afghanistan in the south to Russia in the north.<sup>3</sup> The region connects not only China to Europe, but also Russia to south Asia. Ethno-linguistic and religious groups are spread across the region. Parts of Central Asia are also known as the hotbed of ethnic and religious fundamentalism, giving rise to security concerns.

Although the Central Asian states occupy a single, shared geographic sphere, they cannot be treated as a single entity. Since their independence almost three decades ago, the political divisions and economic competition between and among the Central Asian states have hardened further. They are unlikely to emerge as a monolithic power to reckon with in relation to China and Russia. The borders these states inherited from the USSR were created on the principle of “divide and rule” from Moscow. Without Russia to play the role of arbiter, these borders have become illogical, contested boundaries—fracturing ethnic groups, rupturing trade and communication routes, and breaking economic and political interdependencies.

Central Asian countries can roughly be organized, based on their diverging strategies toward Russia's efforts at re-integration, into two groups. A first group, including Kazakhstan, Kyrgyzstan, and Tajikistan, could be labeled “reluctant followers.” While seeking to maintain as much autonomy as possible, these states have all, for varying reasons, concluded that their only option is to join the Eurasian Union, even at the price of compromising their sovereignty. The remaining countries all oppose membership in the Eurasian Union; but in different ways. Turkmenistan and Uzbekistan—the “rejectionists”—simply stay away from any form of integration, seeking instead to become increasingly self-reliant<sup>4</sup>.

There are many reasons why China is omnipresent in this region, with abundant and accessible energy resources topping the list. Central Asia represents one of the key regions for China in terms of ensuring security, energy supply and alternative economic corridor to high-value European markets<sup>5</sup>. To these ends, China's influence in Central Asia has grown exponentially in the previous decade, with extensive links in

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2. As the five countries generally considered to be within the region all have names ending with the Persian suffix «-stan», meaning «land of».

3. <http://www.silk-road.com/artl/srtravelmain.shtml>

4. <http://www.silkroadstudies.org/resources/pdf/publications/1-1409GrandStrategy-Introduction.pdf>

5. There is already a direct link for rail freight, inaugurated in May 2013, connecting China with Poland and Germany – an average journey lasts 16 days, which is three weeks less than the sea route from China's eastern provinces.

almost every domain including security, geopolitics, trade, investment and energy. The region has risen from a marginal security-related position to becoming one of the top priorities in China's regional strategy<sup>6</sup>.

According to China's strategic plans aimed at its "peaceful rise"<sup>7</sup>, it will take another 33 years - until 2050 - before it can be called a modernized, medium-level developed country – ready to project globally. However, before it gets there Beijing will face three big challenges (i) shortage of resources including energy (food and water, too) to feed its gigantic economy and vibrant society poses the first problem, (ii) environmental pollution and climate change, which present a major obstacle to sustainable development; and (iii) lack of coordination between economic, political and social development<sup>8</sup>. There could also be geopolitical tensions with the US, Japan, Korea and India – not to mention domestic troubles.

China has put a particular priority on relations with Central Asia to foster the development and stabilization of the restive Xinjiang province in the "Middle Kingdom's" west. More importantly, Central Asia has become not only a sustainable energy supply source for China, but also a strategic land-based route to the Gulf and Caspian in order to avoid the "Malacca Dilemma". Pakistan Economic Corridor and Myanmar are other routes considered as part of China's international outreach to the high-value and safe destination markets.

Central Asia is currently even more critical for China as a gateway and a bridge to Iran, the Middle East and Europe as set out in President Xi Jinping's "Belt and Road" vision<sup>9</sup>. China's proposed initiative will impact upon three billion people and connect the biggest markets in the world. Reconnecting China with Eurasia and South-East Asia today is a cornerstone of Beijing's foreign policy, with new development and infrastructure banks being set up, billions of dollars of loans being extended and diplomatic moves all being undertaken to ensure its success. And so far the efforts have worked well, but much remains to be done to sustain this long-term visionary set of projects.

The Central Asian states sought to diversify their export destinations after the collapse of the Soviet Union, yet were often viewed as unreliable partners and risky investment opportunities by many Western corporations. Additionally, with the Caspian Sea being landlocked, the absence of a complex pipeline system to transport resources to Europe proved to be another sticking point. The result was a stagnation of the region's energy industry as the West's reliance on Middle Eastern oil continued, leaving vast resource-rich areas of Central Asia underexplored and large quantities of oil and gas untapped. But the fortunes have significantly improved over the past quarter a century since independence for the region.

Central Asia is set to further boost its importance as an energy gateway in the face of a possible military action around North Korea, which could halt the flow of crude oil imports to South Korea, Japan and China. They together account for 34 percent of seaborne oil trade globally. Global oil markets would be severely affected in the event of a regional conflict that affects South Korea, Japan and China.

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6. China's policy focus towards Central Asia is guided by the strategy of 'March West'. China has a strong interest in a peaceful, stable and prosperous Central Asia. This contributes to ensuring energy supplies and protecting the stability in the autonomous region of Xinjiang, in the country's Northwest. The increasing Chinese influence has sped up competition among major powers to defend their interests in Central Asia, including Russia, the United States, the European Union, Turkey and India.

7. <https://www.foreignaffairs.com/articles/asia/2005-09-01/chinas-peaceful-rise-great-power-status>

8. <https://www.globalpolicy.org/component/content/article/152/25777.html>

9. Now, more than three years on, it has been given many names – from the Silk Road Economic Belt and the 21st Century Maritime Silk Road, to One Belt, One Road to the Belt and Road Initiative.

## China and Russia: is it a marriage of convenience?

China's links with Central Asia cannot be fully grasped without analyzing both the rapprochement between Moscow and Beijing since the end of the Cold War and the potential confrontation in the decades to come as distrust and disaccords are likely to become deeper and irreconcilable. The two powers' deepening accord for the time being, dubbed by some as a "marriage of convenience"<sup>10</sup>, has the potential to significantly shift the direction of geopolitics in North and Northeast Asia as well as in Central and Western Asia.

So far, the Russia-China alignment is strong, but not robust enough. Mistrust is not entirely dispelled. To Moscow, China is its only reliable partner. Not only a huge trading partner, Beijing has also become a military partner, having recently bought advanced missiles and aircraft from Russia to better project power from its own shores and boosting Moscow's military industrial base.

But signs of fraying in the relationship are particularly evident in Central Asia where Russia historically has played the dominant security role. Now China has built an increasingly important economic development role through the Shanghai Co-operation Organization (SCO). More and more, Russia finds itself in a junior role in the relationship with Beijing as China flexes economic strength and becomes a powerful regional force in trade, investment, energy and security.



Graphic©Asia Briefing Ltd.

10. Improved China – Russia Relationship is a Marriage of Convenience, John Grady, March 24, 2016, <https://news.usni.org/2016/03/24/brookings-panel-recent-china-russia-relationship-is-a-marriage-of-convenience>

China and Russia are still complementary economies in some respects. One is rich in resources and high military technology, while the other is good at mass manufacturing and rich in cash. This complementarity is well demonstrated by their partnership in Central Asia, where China provides investment in resource-rich, yet unpredictable, countries while Russia ensures the stability of the ruling regimes. Facing increasing pressure from both east and west, it is unlikely that either China or Russia will seek to change this partnership any time soon, though the countries' willingness and ability may not always match<sup>11</sup>.

Energy collaboration has significantly progressed. Russia signed a major oil export deal with China in 2009, agreeing to supply 15 million tonnes per annum through the East Siberia–Pacific Ocean pipeline (ESPO). Since then, bilateral energy co-operation seemed to always leave a bitter taste: The catalyst for better relations was the 2014 crisis in Ukraine, which estranged Russia from the West. Moscow faced substantial capital outflows and uncertainty around its energy exports to the European Union. China has become the only option in this people. Moscow has since opened up to energy investment from China, removing a number of previous key restrictions on investing in oil and gas resources on Russian soil.

As a result, Russian energy policies toward China over the past decade has changed from reluctant engagement into a priority energy partnership. Russian and Chinese companies further signed several major oil and gas agreements, elevating the status of China as a future energy consumer and lifting bilateral co-operation to a new level. Russian geopolitical considerations and acceptance of vulnerability combined have made long-term Russian energy policies more China dependent. Officially, Russia seeks diversification among Asian energy buyers, but its focus has increasingly been on China.

Western sanctions on Russia have further accelerated this trend. Moscow's energy policies toward Beijing with its pipelines and long-term agreements are clear components of strategic partnership policies. China is eager to increase energy relations with Russian companies, but Beijing also ensures that it does not become too dependent on one supplier. Russian concern over its increased dependence on China in the East is also a real one, but is deemed secondary to expanding Russia's customer base beyond the still-dominant European market<sup>12</sup>.

Increasing oil imports from Russia seems to make good sense to the Chinese leadership now that their territorial dispute with multiple countries in the South China Sea is intensifying. The Straits of Malacca have been a gateway for China for centuries in its quest for power<sup>13</sup>. The long-argued 'Malacca dilemma' — China's heavy dependence on imports travelling through the narrow Malacca Strait between Malaysia<sup>14</sup> and Indonesia and the risk that the US 7th fleet could disrupt maritime shipments in the event of a confrontation in East Asia — seems to finally have its manifesto. Despite a lack of real evidence that choking China's oil and gas imports in the world's busiest strait is feasible or even possible, Russian oil exported through pipelines and trains certainly looks like a safer option.

11. China–Russia energy ties won't short-out, 30 September 2016, Tao Wang, Yicai Research Institute, East Asia Forum, <http://www.eastasiaforum.org/2016/09/30/china-russia-energy-ties-wont-short-out/>

12. Russia's energy relations with China: passing the strategic threshold?, Tom Røseth, *Journal Eurasian Geography and Economics*, Volume 58, 2017 - Issue 1, 16 Mar 2017 <http://www.tandfonline.com/doi/abs/10.1080/15387216.2017.1304229>

13. <https://www.bloomberg.com/news/articles/2017-07-31/chinese-money-pouring-into-malaysia-could-help-najib-razak-with-votes>

14. China is seeking influence in Malaysia as it spreads its economic and military clout through Southeast Asia. It is investing billions in a \$7.2 billion re-development that will see Malacca, long the haunt of Chinese traders, become a new deep sea port. It is also providing funds for infrastructure projects down the eastern seaboard of Malaysia, key heartland areas for Prime Minister Najib Razak ahead of an election that could be held this year. New roads and bridges may help him woo ethnic Malays, but the money could come at a long-term cost.

For Russia, China's oil bill has played a key role in holding up the country's weak economy, especially since the European Union turned its back on Russian gas. But as with all new dancing partners, there are bound to be missteps. The collapse in oil prices since 2014 surprised both nations and hurt most oil exporters' economies. Russia has been among the worst hit. Oil and gas exports account for 50 per cent of its federal budget and 70 per cent of export revenues before the collapse of oil prices in 2014. The huge gas deal signed with China in 2014 is price indexed to oil. Though the exact formula has not been revealed, the price informing the agreement would now be in a very different range from when the deal was inked.

China, too, is hardly in economic paradise. The 'new normal' of China's economic transition is far from stabilized. Competition for the Chinese oil and gas market will only get fiercer as oil producers fail to freeze output and the world's largest growing market faces huge uncertainty. None of these developments are in Russia's interests. But China and Russia's dance will go on as long as the game of international power continues<sup>15</sup>.

Energy ties between China and Russia reflect mutual demands for co-operation in political, security and economic dimensions. They cannot be viewed as driven by only one of them. Talk of a so-called Sino-Russian oil alliance or strategic partnership dates back to Rosneft's landmark deal with CNPC in 2013, reportedly worth \$270 billion over 25 years<sup>16</sup>. But the political optics are an all-too-convenient cover to proffer concerns about Russia and China's supposedly shared interests in disrupting the unipolar world built by the United States<sup>17</sup>. For one, Rosneft's deal to send up to 600,000 barrels of oil daily by pipeline mirrored and reached nearly a decade earlier by private firm Yukos<sup>18</sup>. Much lobbying from Japan, the promise of more flexible Asia-Pacific oil exports, and those in the Kremlin who preferred to avoid tying Russia's regional oil fortunes to China alone won out, though Russia-China pipelines were still built as spurs of the larger ESPO system.

Rosneft's artful maneuvering with Chinese partners - the company has taken tens of billions from CNPC and others to pay off debts without major concessions, has used Indian partners as counterbalance, and sells China natural gas assets to irritate Gazprom - has not stunted momentum in deepening energy trade between the two countries. CNPC began construction of an expansion of pipeline capacity from ESPO to the old oil town of Daqing in August 2016 per the 2013 supply deal. China's crude imports from Russia have also been growing, evidenced by the fact that Russia overtook Saudi Arabia and supplied China with an average of 1.05 million barrels per day in 2016.

ESPO plays a key role in that change. Back in 2011, only 8 percent of ESPO oil went to China, dwarfed by the collective 75 percent bought by Japan, South Korea, and the United States. China bought nearly 70

15. Russia has become a surprising beneficiary of China's deepening oil sector reform. The Chinese government granted approximately 80 million tonnes of crude oil import quota to a number of qualified 'teapot' refineries in Shandong province, an area that previously was only open to China's national oil companies. The move was an attempt to introduce an element of competition to the oil sector.

16. A Chinese oil company agreed in September 2017 to buy a minority stake in Rosneft PJSC for about \$9 billion, deepening energy and political ties with Russia amid increasing tensions with the U.S. The deal sees Glencore Plc and Qatar's sovereign wealth fund selling most of their holding in Russia's biggest crude producer, which they acquired to much fanfare in December. The commodities giant run by Ivan Glasenberg is making way for CEFC China Energy Co. while retaining its prized access to millions of barrels of Russian oil exports.

17. The Reality of the Sino-Russian Oil Alliance, Nicholas Trickett, April 26, 2017 <http://thediplomat.com/2017/04/the-reality-of-the-sino-russian-oil-alliance/>

18. Rosneft hungrily devoured it via legal blitzkrieg against Mikhail Khodorkovsky and his firm. Yukos was not negotiating with its Chinese counterparts on the basis of Russia's strategic interests and its original pipeline proposal morphed into the ESPO pipeline running to Vladivostok.

percent of all oil traded through the ESPO port of Kozmino in 2016, roughly 445,000 barrels a day<sup>19</sup>. In this process, Japan and South Korea - Russia's preferred regional trade partners to balance China - have reduced their take of Russian oil, finding crude supplies from Iran and Saudi Arabia more attractive. These trends fit into broader regional dynamics Russia must negotiate if it wants to use its oil wealth as an instrument of foreign policy in the Asia-Pacific region.

Not only in hydrocarbons, both countries have recently started working on renewables as well. Despite the fact that Russia is one of the world's largest exporters of oil and gas, in recent years the country has actively been developing alternative energy. Experts say that China, which is interested in inexpensive energy supplies from Russia's Far East, is giving Russia a hand<sup>20</sup>.

In July 2016 the new BRICS Development Bank, created on the initiative of Russia, China, Brazil, India and South Africa as an alternative to the International Monetary Fund, issued its first "green bonds." The total value of the bonds was three billion yuan (\$448.5 million), and the money received will go towards the realization of ecological projects, including alternative energy. This is not the only example of cooperation between Russia and China - Chinese companies are also increasingly investing in the construction of Russian solar and wind power stations<sup>21</sup>.

It is important to note that today about 17 percent of all energy in Russia is produced from alternative sources. However, for a long time the country lacked state programs to support alternative energy. Such a programme was introduced only in 2013<sup>22</sup>. Large Russian corporations, including state-owned companies, have decided investing in alternative energy. For example, RusHydro, Russia's largest hydroelectric power plant operator, plans to construct mini plants with Power China. Investments are projected to amount to \$1.7 billion by 2020. Furthermore, RusHydro also plans on building 139 solar stations, 35 wind stations and two wind farms.

Another Russian group, Rosnano, a state company created by Anatoly Chubais to develop nanotechnology, is also very active in the development of alternative energy. Chinese authorities are primarily interested in creating additional energy generation for the country's needs, and this makes Russia's Far East extremely interesting for Chinese investors. China's ecologically dirtiest areas border this area, while neighboring Russian regions are oriented precisely towards developing alternative energy.

For both nations, opaque decision-making processes in government as well as in each country's powerful NOCs mean that good bilateral communication and understanding are not always ensured. Sometimes their interests may be at odds.

Uncertainty surrounding the progress of China's economic transition, SOE reform and future developments in energy technology could lead to a range of very different scenarios. These developments could either reinforce or destroy energy ties between China and Russia. But in the years to come, the world should

19. <http://www.reuters.com/article/northkorea-usa-russia/as-u-s-and-china-find-common-ground-on-n-korea-is-russia-the-wild-card-idUSL4N1HX1SQ>

20. Russia and China Join Forces to Develop Green Energy, September 6, 2016, Alexey Lossan, <http://www.diplomaticcourier.com/russia-china-join-forces-develop-green-energy/>

21. Russia has deep roots in alternative energy. The country's first hydroelectric power plant appeared in 1892, in Siberia's Altai region, and produced electricity with four wooden turbines, each with a 45 kilowatt capacity. In the 1930s the USSR was first in the world to make wind generators, and in the 1960s the country produced the first power stations using geo-thermal energy from the Earth.

22. <https://www.worldenergy.org/wp-content/uploads/2016/10/World-Energy-Resources-Full-report-2016.10.03.pdf>

not be surprised to see more energy deals signed by these two countries. Economic facts on the ground complicate Russia's political aims in finding a broader range of energy security partners as it seeks a bigger role as an energy security guarantor in Northeast Asia and the Asia-Pacific at large. Any political strategy using oil diplomacy lives and dies at the whim of market forces far beyond Russia's control, a fact often lost in the never-ending chatter about Russia and China's complicated relationship.

## How would Moscow and Beijing deal with Central Asia?

The geography, history and strategic imperatives dictate strong engagement in Central Asia from both Russia and China. With the help of its newfound strategic partner, China, Russia intends to checkmate the United States' regional pre-eminence. Central Asia has long been considered part of Russia's footprint, not least because several million Russian-speaking people — mostly in Kazakhstan (3,644,529), Kyrgyzstan (364,600) and Uzbekistan (650,000) — share a sense of belonging to its culture and history. However, this is not the only reason Moscow is paying attention to events in Central Asia. The region's states are Russia's close neighbours, and the security challenges they face affect Moscow's national interests.

Russia has turned its security concerns into ruthless military actions. Russian President Putin seized the initiative in his military attack on Georgia in 2008, in his multi-dimensional but non-military assault on Kyrgyzstan in 2010<sup>23</sup>. Each of these initiatives, and many others that lacked a clear military component, constituted a direct assault on an international system built upon territorial integrity and accepted notions of sovereignty. Russia's invasion of Georgia was not merely a response to that small country's seeming to thumb its nose at the Kremlin, but an important building block in Putin's much larger geopolitical edifice.

In the end, Putin himself dispelled all doubts on this matter when he attempted first to prop up what he took to be a pro-Moscow government in Kiev, then seized Crimea, and finally invaded Ukraine, first with a motley but well equipped band of irregulars, and then with regular Russian army forces.

Russia has revamped its Central Asia policy in recent months with a major outreach to Pakistan and stepping forward as a power broker in Afghanistan, its former stomping grounds. But the maneuvering has also brought Moscow in opposition to New Delhi<sup>24</sup> with which it has traditionally shared robust ties. Any new power equation in the region will have long-term implications.

For its defense matrix, India cannot afford to marginalize Russia as it still is the only country selling critical strategic technologies to India. In recent years, India has grown concerned about Russia's growing closeness to China and especially the overtures to Pakistan. Vladimir Putin, intent on viewing Central Asia through the prism of Russia's geopolitical competition with the West, may have decided that the time was right to tilt towards Pakistan. U.S.-Pakistan ties may have hit their nadir and the new U.S. administration, expressing isolationist tendencies, remains consumed by multiple domestic crises. The global arms market has become more difficult for Russia to navigate, with China deciding to produce its own weapons rather

23. <http://www.silkroadstudies.org/resources/pdf/publications/1-1409GrandStrategy-Introduction.pdf>

24. Since the 1960s, Russia has been a close partner of India in Central Asia. This relationship has stood the test of time even as global power equation changed after the end of the Cold War. During the Cold War, the high point of the relationship was the signing of the 1971 Indo-Soviet Treaty of Peace, Friendship, and Cooperation, which signaled a decisive shift away from the West in response to an emerging U.S.-Pakistan-China axis in Central Asia. Though not an explicit military alliance, this treaty was a sharp departure from India's professed policy of non-alignment, and New Delhi emerged as a close partner of the Soviet Union during the Cold War. The treaty, in effect, created a deterrent against any form of U.S.-Pakistan-China detente and rendered India increasingly dependent on the Soviet Union for defense capabilities.

than procuring them from Russia. Moscow needs new buyers.

Russia, in concert with China, challenges U.S. strategic priorities on multiple fronts, and regional theaters like Central Asia are likely to face the brunt of this geopolitical competition, putting older relationships under strain even as new ones take shape. It looks as though the recent North Korean crisis is bringing Moscow and Beijing together. Russia believes that Pyongyang's aim is not to bomb anyone, that its nuclear programme is a deterrent against South Korea and the US. Russia is just as paranoid about American 'democracy promotion' as North Korea is<sup>25</sup>.

Security is a key agenda item for all. China has set up an anti-terrorism alliance not only with Russia and Central Asia but also with Pakistan and Afghanistan in order to boost co-ordination with regional countries to tackle a growing domestic militant threat.

Finding the right balance in the long-term between rivalry and resonance may be difficult for Beijing and Moscow to achieve. Both Russia and China have unveiled grand-scale visions to be played out, at least in part, in Central Asia.

They have sought to position their separate projects as compatible, but critics dicker with whether the insular Eurasia Economic Union (EEU) and expansive Belt and Road Initiative (BRI) can really connect in anything but rhetoric. Furthermore, both the EEU and BRI have little, if any, focus on issues like rule of law, social welfare, health, education, or environmental protection, which have serious repercussions for not just the security of their investments but the future of the region's states and peoples<sup>26</sup>.

The Russian-led EEU, established in 2015, creates a customs union among former Soviet states orienting their economies toward Moscow. They have divergent goals, but Russia and China have committed to cooperate politically and economically. Their initiatives offer investments and enhanced co-operation in a region beset by economic and political challenges. Poorly handled, however, these initiatives could encourage and entrench local behaviour that risks generating instability and conflict<sup>27</sup>.

Chinese analysts see the EEU's primary aim as helping Russia recover its great power status and institutionalise its regional sphere of influence. To the extent that it facilitates policy coordination and promotes peace and stability, they reckon it may benefit the BRI. But Chinese scholars also tend to be sceptical of the EEU's long-term prospects, viewing it as a defensive, inward-focused construct that will exacerbate Russia's geopolitical rivalry with the West.

They also point to the union's lack of economic rationale or common market, the potential for territorial disputes among members, and the tension between its binding mechanisms and the natural tendency of Central Asian states to balance between Beijing and Moscow. They assess that Russia will have to make further concessions to satisfy the divergent, centrifugal interests of the other members and, in the absence of reforms to its own economy, bear an increasingly heavy burden.

Beijing and Moscow undoubtedly share similar worldviews towards Central Asia and vis-a-vis the United

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25. <http://www.bbc.co.uk/news/world-europe-41172488>

26. Energy and Geopolitics. China and Central Asia, Mehmet Ogutcu and Xin Ma, Kazakhstan International Business Magazine №3, 2007, <http://www.investkz.com/en/journals/53/428.html>

27. <https://www.crisisgroup.org/europe-central-asia/central-asia/245-central-asias-silk-road-rivalries>

States, which they see as a “common threat” in the region. But as a recent report<sup>28</sup> points out, the two regional initiatives have also some fundamentally divergent goals because each is designed to benefit the country at its core. China’s BRI, by fiat of geography, cannot ignore Central Asia on its way to Europe and Central Asia’s shared border with China’s Xinjiang boosts the economic logic with security rationale. The Belt and Road, which isn’t so much a set plan as an opportunistic stitching of relevant projects together, nonetheless brings the heft of actual funding into a region in desperate need of infrastructure development.

The EEU, on the other hand, is “a customs union among former Soviet states orienting their economies towards Moscow.”<sup>29</sup> The customs union aims to promote free trade and movement within the union, and imposes tariffs on external imports. The EEU is also seen as an attempt to resurrect the Soviet Union, while more nuanced observers — such as the authors of a Chatham House report on the EEU<sup>30</sup>, released in May 2017 — view the EEU as part of Moscow’s effort to “strengthen its own global influence,” but that Russia is not “preoccupied with making it work.”

China since 2015 has been engaged in an ambitious programme known as ‘Belt and Road’ (BRI) to develop land and sea trade routes as a means of further integrating itself into the global economy. A key element of BRI is reviving the ancient Silk Road through Central Asia: China is aiming to make the region a viable overland transit route for trade with Europe, and to create new demand for Chinese exports in Central Asian markets. In connection with this initiative, China is financing sweeping infrastructure improvements — roads, rail, ports, telecoms and IT. But many challenges lie ahead in a region with messy borders, uncertain political futures and a legacy of Soviet working practices.

Flanked on either side by the Russian and Chinese behemoths, Central Asia offers a largely unexploited transit zone from Asia to Europe. The Central Asia portion of BRI is China’s bid to capitalise on this, though significant Chinese investment in the region predates the official announcement of the programme in September 2013. BRI represents a web of connections rather than a single path. Its northern corridor will transit through Kazakhstan to Russia, its middle corridor through the Caspian Sea. But it also foresees a host of roads, bridges and tunnels elsewhere across the region<sup>31</sup>.

To be precise, the BRI aims to open trade routes for China across its vast continental hinterland while creating a zone of security around its troubled western region of Xinjiang. It is an umbrella concept rather than a clear set of projects. The first stage involves multi-billion dollar investments building rail and road links to Central Asia and across it to Iran, Russia, the Caucasus, Turkey, and Europe. China aims to reduce physical, technical and political barriers to trade, in pursuit of its longer-term goal of a free-trade agreement across the region. Poorer countries, such as Tajikistan and Kyrgyzstan, hope for investments in agriculture and industry to boost their economies<sup>32</sup>. The plan also has a strategic and ideological dimension, extending

28. The International Crisis Group’s “Central Asia’s Silk Road Rivalries”, which takes a look at China’s Belt and Road Initiative and Russia’s Eurasian Economic Union

29. Strategic Geography and the Changing Middle East, G. Kemp, R. Harkavy, Washington, DC: Carnegie Endowment for International Peace, 1997

30. <https://www.chathamhouse.org/publication/eurasian-economic-union-deals-rules-and-exercise-power>

31. <http://riskmap.controlrisks.com/where-next/china-in-central-asia/>

32. The Kazakh-China oil pipeline, completed in 2005, is designed to carry oil from Kazakhstan’s offshore Kashagan project. The China-Central Asia pipeline is the main export route for Turkmen gas, leaving it heavily dependent on its partners in Beijing. A further “D” branch of this pipeline is delayed. Chinese economic activity is not only about connectivity and trade but also about investment in industry. In Kyrgyzstan a Chinese-run cement plant is operating in Aravan, with others announced for Issyk-Kul and Osh. In Tajikistan, Chinese investors established several new cement plants and production increased fivefold between 2013 and 2015. The power sector is another significant area of investment.

Chinese political clout, promoting a state-led development model and providing security. If successful, it could form the first step in a new kind of international order in which China plays a leading role.

Chinese plans are not without serious challenges. Political sensitivities in this region are high. While Central Asian elites welcome an influx of funding, Chinese investors often encounter popular suspicion and xenophobia. For example, rumours of land being leased to Chinese investors sparked protests in Kazakhstan in May 2016. A suicide bomb attack on the Chinese embassy in Bishkek in August 2016 raised fears in Beijing about security vulnerabilities. Many investment deals do not benefit the wider population and are accompanied by accusations of high-level corruption. There also are environmental concerns as China exports polluting industries into the region. This combination of nationalism, anger over corruption and environmental impacts could further fuel anti-Chinese sentiment in Central Asia. As one Chinese scholar explained it, "most of the people in Central Asia who have strong negative sentiments against China are not powerful, while those who have power want to work with China."<sup>33</sup>

The Belt and Road model represents a de facto challenge to the economic development model promoted by Western states which emphasises structural and policy reforms and technical assistance in sectors such as education and health, but largely avoids public infrastructure. Western focus on systems and systematic changes can be tedious as they entail altering the very same systems of corruption which have kept Central Asia's elites at the top. But increasingly, publics in countries like Kyrgyzstan, are paying attention to who wins contracts for projects and how.

The countries of Central Asia - most of which have autocratic or semi-autocratic governments - welcome infrastructure investment but are wary of what has been perceived as Western lecturing on democracy and human rights. China, on the other hand, defines human rights with a focus on economic well-being.

If the BRI is successful, some analysts speculate that it could form the basis for a new kind of international order, in which China plays a leading role. In this sense, Central Asia is a testing ground for new ideas in China's foreign policy. For this to succeed, funding is essential. China's National Reform and Development Commission said in March 2017 that China had invested over \$50 billion in countries along the Belt and Road since 2013 and signed contracts for new construction projects worth \$304.9 billion between 2014 and 2016. Specific figures are more difficult to calculate. In November 2014, President Xi announced a \$40 billion Silk Road Fund to be used "to provide investment and financing support for infrastructure, resources, industrial cooperation, financial cooperation and other projects in countries along the Belt and Road".

At the May 2017 Belt and Road Forum he announced a further 540 billion yuan (\$79.4 billion), including 100 billion yuan (\$14.7 billion) more for the Fund. By late 2016, the Silk Road Fund had committed to deals amounting to at least \$3.25 billion, although its initial investments were in Russia, Pakistan and Europe rather than Central Asia.

The Asian Infrastructure Investment Bank (AIIB), with \$100 billion in capital, also is expected to be a source of finance for the BRI, albeit beginning loans up to \$2 billion in its first year, mostly in conjunction with other multilateral lenders. The Export-Import Bank of China and the China Development Bank will continue to play the most important roles in funding BRI projects, particularly for the BRI in Central Asia, using their established practice of soft loans to governments conditioned on the use of Chinese contractors.

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33. <http://thediplomat.com/2017/07/china-and-russia-in-central-asia-rivalries-and-resonance/>

Whatever said to the contrary, the BRI also challenges Russia, which separately has been bolstering its regional role by building its own institutions. In May 2014, Russia, Belarus and Kazakhstan (joined in 2015 by Kyrgyzstan and Armenia) set up the EEU, loosely modelled on the EU. The EEU aims to promote free movement of goods, labour, services and capital within its borders while imposing tariffs on external imports. However, the EEU is slow to deliver on its promise of greater economic integration. Trade among members has fallen since 2015 in terms of both volume and value, due to the devaluation of the ruble, though it has picked-up slightly in 2017.

There are political limitations, too. Uzbekistan and Turkmenistan make clear they will not join and likewise reject membership in the Collective Security Treaty Organization (CSTO), a Russian-led security bloc. Despite China's strong standing, Russia remains a key partner for the Central Asian countries. Its deep and multi-layered political, social and cultural influence in Central Asia currently surpasses that of China.

Whether they can smoothly work in tandem or not, Russia and China have committed to co-operation between the EEU and the BRI. Moscow has promoted the notion of "Greater Eurasia", a nebulous project that would link China, Russia and Central Asia in a new economic and political bloc, and sees cooperation with China as intrinsic to this. But fundamental contradictions loom between the EEU's inward-looking customs union and China's push for free trade across the region and into Europe. Moreover, Central Asian states each have agendas of their own and overcoming obstacles to regional trade will prove difficult. Thus, Kazakhstan is keen to maintain strong links with the West to balance Russian and Chinese involvement while Uzbekistan, despite showing signs of seeking better relations with its neighbours, still restricts free trade across its borders.

Russia's EEU is the product of Moscow's continued primacy in areas of politics and economics in the region, as well as long-established personal and institutional links. Both Beijing and Moscow have made statements about how well the BRI fits with the EEU, but the slow diplomatic pace with regard to weaving the two together in anything more than rhetoric, reflects a process through which Russian strategists have eventually concluded it is more in Russia's interest to shape China's initiative than to resist it.

Notably, China's BRI-branded projects are usually arranged bilaterally, never through the EEU. If the EEU is burdened by its members "divergent, centrifugal interests," the Belt and Road is "conceived as an open web of bilateral agreements" in which the economic benefits are "explicit," and the political expectations to support Chinese policies such as the One China Policy and efforts with regard to Xinjiang, are implicit<sup>34</sup>.

Beijing and Moscow have successfully managed to keep the West at a distance in Central Asia. The West's place in Central Asia — and its relation to the Chinese and Russian projects — is comparably insignificant. The EU and the U.S. are still actors in Central Asia, but increasingly marginalised by the rise of China and a re-assertive Russia<sup>35</sup>.

Central Asia policy is at the end of the list of policies the Trump administration needs to consider and potentially revise. It is crucial for Washington not to cede this arena to Russia and China. Most importantly, in the medium term is concentrating on areas where tangible change is possible, such as health, education,

34. <https://www.crisisgroup.org/europe-central-asia/central-asia/245-central-asias-silk-road-rivalries>

35. Both Russia and China pay relatively less attention to the rule of law, social welfare, health, education and environmental protection. The EU and U.S. may wish to explore ways to engage with both initiatives and use this to push for good governance, as well as environmental and labour standards. In the end, this should not be done at the cost of adopting an uncritical approach to authoritarian regimes.

and the environment and strategizing on more touchy issues like democracy and human rights with the EU, Japan, and South Korea. Importantly, security should not be the only U.S. priority. But fitting U.S. interests within the frameworks provided by Russia and China will be, in many ways, a serious challenge. In the same way, finding the balance in the long-term between rivalry and resonance may be difficult for Beijing and Moscow.

## Powershift to China away from Russia?

It is evident that China's rise in Central Asia has caused a significant powershift, accelerating the competition among great powers to defend their interests in region, which has drawn comparison to the "Great Game", a period of intense rivalry between the British and Russian empires in the 19th century, as both empires sought to expand their influence in Central Asia. This time, in addition to Russia and the US, other powers such as the EU, Turkey, Iran and India have different economic, political and security interests to pursue in Central Asia<sup>36</sup>. China wants to make sure that the US will not be allowed to establish a strong presence in the region as part of its long standing "China containment" strategy.

These shift of orientation has come at the expense of Russia's traditional influence and interests in the region. Landlocked, with China to the east and Russia to the north and west, Central Asian leaders have had to balance their alliances with the powers that surround them. Kazakhstan continues its multi-vector policy by deepening its non-Russian relationships through bolstering defense ties and diversifying materiel procurement, while shifting its focus to a policy of increasing its own economic and military power in order to remain sovereign<sup>37</sup>. The Turkmen government has been proudly proclaiming its UN-recognized status as a neutral country for more than 20 years now. Ashgabat's policy of «positive neutrality» is, since September 2016, even part of the country's constitution<sup>38</sup>. Uzbekistan has stepped up its reforms and opening to the outside world under its new president Shavkat Mirziyoyev succeeding the late Islam Karimov<sup>39</sup>.

The Central Asian states entered into regional co-operative organisations with China and Russia like the Shanghai Co-operation Organisation (SCO) in the hopes of controlling the influence each power exerted on the five nation-states. Some of them are in Russia-led EEC and the Collective Security Treaty Organization, a Eurasian NATO of sorts<sup>40</sup>.

Russian officials and analysts talk of "Greater Eurasia" in which Moscow serves as a key pivot in a region stretching from Eastern Europe to East Asia. For Kazakhstan and Kyrgyzstan, this involves a complex balancing act. Both capitals do not wish to get caught up in Russia's complex geopolitics. They, for example, refused to join Russia in imposing sanctions on agricultural imports from North America and the EU or on imports from Turkey in 2015. They maintain relations with Ukraine despite Russia's conflict with Kyiv. But, they also see benefits in a project that can promote Eurasian integration.

Kazakh President Nazarbayev called for Eurasian integration in 1994 likely a way of cementing Russian-Kazakh relations without undermining Kazakh national identity. After land-related protests and terrorist attacks in north-west Kazakhstan in May-June 2016 which the Kazakh government blamed on Islamic

36. [http://www.eias.org/wp-content/uploads/2016/02/EU-Asia-at-a-glance-Yu\\_Xichao-China-Central-Asia.pdf](http://www.eias.org/wp-content/uploads/2016/02/EU-Asia-at-a-glance-Yu_Xichao-China-Central-Asia.pdf)

37. <http://globalinterests.org/2016/04/28/the-future-of-kazakhstans-multi-vector-policy/>

38. <https://www.rferl.org/a/turkmenistan-neutrality-iran-gas-dispute/28226071.html>

39. <https://www.theguardian.com/world/2016/dec/05/uzbekistan-elects-shavkat-mirziyoyev-president-islam-karimov>

40. Yet despite Russia's best efforts, the CSTO has not become the powerful tool Moscow hoped for.

extremists, Russian nationalists talked about a potential Russian military intervention in northern Kazakhstan, home to a sizeable ethnic-Russian minority. But the appeal of separatist tendencies is lessened by Kazakhstan's membership in the EEU since it mitigates fears of ethnic Russian minorities. In other words, the concept of Eurasia is useful for Kazakhstan, both in managing relations with Russia and in bridging its own internal ethnic divides.

In reality, the concept of Greater Eurasia for now is mostly rhetorical. The EEU struggles to find new members. Leaders in Uzbekistan and Turkmenistan are implacably opposed and seem to privilege ties with China. In 2015, China became Uzbekistan's main trade partner taking the top spot from Russia. When Xi Jinping visited Uzbekistan in June 2016, he became the first foreign head of state to address the Uzbek parliament. That said, in some ways, Uzbekistan already is economically integrated with the EEU zone: at least two million Uzbeks work in Russia, although their numbers have declined as they face increased hurdles to migration and lower wages.

Turkmenistan takes an even stronger stance against regional integration, informed by its official ideology of "neutrality", which in practice is a policy of self-isolation. Turkmenistan attended the initial meeting of the SCO in 2007 but refused to join and has rejected any possibility of EEU membership. Unlike other Central Asian countries, Turkmenistan has few labour migrants working in Russia and limited trade with EEU states. Its main exports, oil and gas, flow primarily to China. Russia's Gazprom was a major buyer of Turkmen gas but suspended purchases in early 2016. Turkmenistan also suspended exports to Iran in 2016. As a result, it now heavily relies on China.

Tajikistan is more likely to join the EEU but, among other factors, China's allure may encourage it to resist. Remittances from Russia declined sharply in 2015-2016 but still remain the main source of income for a majority of the population. Membership has public support because it could improve the legal status of hundreds of thousands of Tajik labour migrants already in Russia. However, given Russia's deep recession and the high costs associated with funding Tajikistan's integration in the economic bloc, Tajikistan's early accession is growing less attractive to Russian officials.

Still, Russian diplomats are confident of Russia's privileged position in Central Asia. They are keenly aware of anti-Chinese sentiment in the region and trust that over the long term it could work to Moscow's advantage. The scale of Chinese investment cannot be matched, but Russia views its linguistic, cultural and military links as insurance against Chinese overreach. Vital to Moscow's connection with the region are the millions of Central Asian migrants working in Russia and the remittances they send home annually. Though the value of remittances may fluctuate they are a lifeline to Central Asia's poorer economies.

China is clearly poised to make a spectacular economic conquest of Central Asian markets. In 2016, China became Uzbekistan's largest trading partner with \$3 billion worth of trade and Kazakhstan's largest investor with 33 deals delivering \$23.6 billion to the nation. China has also focused heavily on Turkmenistan's energy sector where it has been purchasing some 30 billion cubic meters of gas a year since 2009 while providing substantial military aid. China also took over in Kyrgyzstan as the builder and partner in several hydro-power projects<sup>41</sup>.

The damage caused by sanctions have impacted rather more on the EU. New public transport infrastructure in Moscow and Saint Petersburg such as buses and trains, for example, are now sporting Korean and

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41. <http://globalriskinsights.com/2016/05/why-central-asia-is-dumping-russia-for-china/>

Chinese manufacturer logos instead of European ones. GDP growth is returning in 2017, with the World Bank anticipating 1.5 percent growth this year<sup>42</sup>, coincidentally the same growth rate as can be expected in the EU. In fact, the Russian economy is now on the upswing, while the EU's is slowing down. The sanctions have also been a boon for Sino-Russian trade, which has significantly picked up over 2016.

Central Asia's Russian ties may be becoming compromised due to Russia's domineering behaviour, with Moscow treating the region like its exclusive hoard. Buying oil, gas and minerals at below market rates only to re-export it to elsewhere at a mark-up has pushed countries like Kazakhstan and Turkmenistan into the arms of China, which offers better trade and financial terms. In this environment it is easy to see why China has come to be viewed as an economic stabiliser and a necessity by Central Asian governments in the past few years.

Obituaries, though, about the demise of Russia's place in Central Asia is premature. For Russia, it is clearly an arena in which to exert political influence and keep it in the "near abroad" periphery. Russia views Central Asia as its personal Achilles Heel and prefers to keep close ties in the region economically, politically, and militarily. Kazakhstan is the most important ally for Russia in the region<sup>43</sup>.

In a dramatic change, the most shocking response to North Korea's 3 July 2017 missile tests – which some analysts think demonstrates Pyongyang's ability to strike Alaska or Hawaii with a ballistic missile – came not from Donald Trump, but from Beijing and Moscow. Trump's public pressure on Beijing highlights how China's strategic goals for Pyongyang overlap with Russia's – and how they differ from the United States. Xi and Trump share the quixotic desire for the denuclearization of the Korean peninsula, and the equally unrealistic wish for Kim to act with more predictability and restraint. The similarities basically end there<sup>44</sup>.

Washington wants the peninsula unified under Seoul. Moscow and Beijing both appreciate North Korea's existence as a buffer state between their countries and the democratic, western-leaning South Korea, which houses US troops. While North Korea's largest northern border is with China, it also shares an important border with Russia. There is less ambiguity between China and its northern neighbour: though Moscow sometimes resents it, Russia is clearly the junior partner in the relationship. Instead of finding common cause with Washington in the wake of Pyongyang's latest test, Beijing turned to Moscow. The reasons for an improvement of Sino-Russian ties extend beyond North Korea. Despite Putin's relationship with Trump, both Moscow and Beijing find the American-led international framework problematic: they seek to expand their influence over or subvert current international institutions, while at the same time creating alternative ones<sup>45</sup>.

And they have recently improved military relations – Beijing recently purchased Russian high-tech military equipment, and the two sides have expanded the geographic scope of Sino-Russian military exercises. In the 1950s, the last time Beijing and Moscow were this close, the Soviet Union's global reach threatened the United States – but China was shambolic, and desperately poor. Now, China is the world's second-most influential country, while Russia maintains its status as regional power. If the two sides keep expanding

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42. <http://www.china-briefing.com/news/2017/01/11/china-in-2017-increasing-trade-alliances-with-eurasia.html>

43. <http://oilprice.com/Energy/Energy-General/Putin-Seeks-Greater-Influence-in-Central-Asia.html>

44. In pushing for sanctions, Washington wants to economically strangle North Korea. Beijing and Moscow prefer economic engagement. Beijing has long seen North Korea as a client state: it will not allow the United States to dictate Beijing's foreign policy strategy towards its neighbor.

45. <https://www.theguardian.com/commentisfree/2017/jul/05/trump-north-korea-strategy-china-russia>

their common interests, that could be far more devastating to the United States' long-term interests than Kim and his missiles.

## Energy matters a great deal

China, Russia and Central Asia heavily depend on one another in energy as producers, transit and consumers. A powerful motive for China's stronger engagement in Central Asia is to satisfy its growing energy appetite. China needs energy imports: Russia and Central Asia must export. The massive import requirement is a reality today and likely to be so in the future given China's growing economy in the coming decades. Chinese companies not only build infrastructure, trade and invest in Central Asian markets, but also they are increasingly becoming regional energy investors, buyers, transporters and traders<sup>46</sup>.

China faces a production problem: its largest fields are maturing and expensive to maintain, low oil prices are hurting investment and accelerating production decline, and its oil demand is going to keep growing<sup>47</sup>. China is becoming more dependent on overseas natural gas as it seeks to wean itself off coal and avoid the toxic smog that suffocates the country every winter. The world's largest energy user will increase imports of liquefied natural gas about 30 percent in 2017 as domestic production stagnates and the government pushes cleaner fuels in an effort to clear polluted skies. Imported gas, including both seaborne and pipeline supplies, may account for about 40 percent of the country's gas use by the end of this decade, up from roughly a third last in 2016.

China's possible rising reliance on imported natural gas, along with its plans to spend \$360 billion through the end of the decade on renewable energy generation, highlight the challenges facing government of President Xi Jinping as it seeks to throttle back poisonous air that blankets the northern part of the country during winter. Coal accounted for about two-thirds of the country's primary energy consumption in 2015<sup>48</sup>.

China's dependency on imported energy has surged and is expected to grow at an increasing rate, despite the "new normal" growth of around 7 percent, in the coming decades, driven by an unprecedented industrialization mobilization and urbanization process. As a result, the Chinese leadership feels increasingly insecure and vulnerable as greater dependency has exposed the country to the risks of global supply disruptions, chronic instability in energy exporting regions, security of shipping lanes, and the vagaries of global energy geopolitics.

From this perspective, Central Asian/Caspian countries offer the best available option for China to reduce its dependence on the Gulf (as well as Russia) and help avoid the 'Malacca dilemma' as the transportation from these countries is relatively secure, short and by land-based pipelines<sup>49</sup>.

Paired, these developments create more flexibility for Russia's non-state owned firms to compete, create

46. Recognizing this reality, Beijing began giving licenses to independent "teapot" refineries in 2015 to ease along market reforms that would make China's state-owned oil firms more competitive. Teapots contributed over 90 percent of China's import growth in 2016, a trend that will likely continue. China's crude oil imports rose to 9.21 MMbpd (million barrels per day) while crude oil production fell 4.6 percent to 3.9 MMbpd in March 2017. Slowing Chinese crude oil production due to aging could also increase China's crude oil imports.

47. <http://marketrealist.com/2017/04/chinas-crude-oil-imports-hit-new-record/>

48. China Is Shaping Up To Be A World Leader On Climate Change, JANUARY 20, 2017, Nicholas Stern, Financial Times, <https://www.ft.com/content/3f1ba5ba-ddac-11e6-86ac-f253db7791c6?mhq5j=e1>

49. Growing links in energy and geopolitics: China, Russia, and Central Asia, Mehmet Ögütçü and Xin Ma, <http://www.eisourcebook.org/cms/Links%20between%20energy%20&%20geopolitics,%20China,%20Russia,%20&%20Central%20Asia.pdf>

greater flexibility for Chinese firms to trade oil outside of long-term supply contracts, and make rising Russian oil imports a necessity distinct from discussion of China's "Malacca Dilemma," the pressing security concern that reliance on imports traveling through sea routes patrolled by rival powers' navies could pose an existential threat in a time of crisis.

China's leadership has responded to the energy security challenge with both energetic domestic reforms and aggressive global energy security policies. Domestically, efforts are underway to promote domestic production and national level transportation network, and to improve energy efficiency. The domestic oil industry also has been repeatedly restructured to try to boost competition and efficiency and oil pricing has been brought more closely in line with global and regional oil markets.

Internationally, China pursues a number of approaches to tackle energy security: diversification of import sources and transportation routes, active energy diplomacy by the government, promoting wide package of political, economic and energy inter-dependence with core oil producing countries; direct upstream investment by the Chinese national oil companies.<sup>50</sup> As over half of Asia's overall energy imports travel through the narrow three-mile-wide Malacca Straits, a significant maritime dispute in South East Asia carries the potential to reverberate far into the Chinese hinterland and its economic sustainability. Thus, Beijing's acquisition of Central Asian energy is not merely sound business policy, but an insurance against a serious threat to its foreign energy links in Africa and the Middle East.

The rapid development of Central Asia's energy infrastructure has made it a region that finally looks ready to fulfill its potential in delivering the burgeoning energy needs of China<sup>51</sup>. Therefore, it is no surprise that China has made this region a cornerstone of its energy security policy in order to diversify its import sources for avoiding the risks of over reliance on one single source of supplier. The lack of a strong U.S. military presence in this geography, especially one that can counter China's massive land power, has made Central Asia an appealing source of energy in the eyes of Chinese strategic planners.

## Enough energy in Central Asia?

Central Asia has long possessed large volumes of oil, natural gas and hydropower, predominantly located in the five former Soviet republics situated to the east of the Caspian Sea: Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Historically, the persistence of Soviet influence over Central Asia's energy sector led to the majority of Caspian oil and gas to flow north to Russia, and from there onward to the industrialized consumer countries of Western Europe.

For decades, Central Asia's energy infrastructure remained underdeveloped, with producers in the region struggling to transform their raw natural resources into output, while also having difficulty finding reliable methods of delivery.

However, the picture has altered significantly since the turn of the century: access has been opened to new markets in the east, and Central Asia now plays a vital role in meeting China's energy needs and probably the future of India, which is in a worse position than China in energy supply security. This turnaround in fortunes has been driven largely by a shift in outlook, with a new focus on the new energy-

50. Xiaojie, X. (2000). «China and the Middle East: Cross-Investment in the Energy Sector.» Middle East Policy 7(3).

51. China and the world energy system: new links, Mehmet Ögütçü, the journal of energy and development, vol. 23, no. 2 (spring, 1998), pp. 281-318

hungry markets which surround Central Asia. The close geographical proximity of the world's two fastest growing economies, along with the presence of a shared land border between three of the Central Asian producers and China, has led to the rapid development of the region's energy market, while a surge in investment from the east has facilitated its reorientation, diversification, and revitalization<sup>52</sup>.

In particular, this has been enabled by China's drive for energy security. China has begun investing heavily also in the downstream sector, building oil refineries and pipelines across the region to satisfy its domestic demand, whilst maintaining its commitment to a win-win approach based on mutual benefits.

Since shifting from an oil exporter to a net importer of crude in 1993, securing access to energy resources from overseas has been a core concept of China's internationalization strategy. As dependencies have grown on oil flowing from the volatile regions of the Middle East and Africa, and passing through strategically vulnerable choke points such as the Strait of Hormuz and the Strait of Malacca, diversification of suppliers and supply routes has become a mantra for Chinese overseas investments. Many of the pipeline projects being subsumed by an BRI logic today, such as oil and gas pipelines from Central Asia, Russia or Myanmar, have been in operation, development, or negotiation for years, but are now being increasingly painted with an BRI brush.

Kazakhstan is the region's leading oil producer and ninth-largest country in the world, and has become China's major energy partner in Central Asia as the two countries share a 1,700 km land border. China controls approximately 20 percent of Kazakhstan's oil production and has constructed one of the world's longest oil pipelines, running 2,300 km from the Caspian Sea to Xinjiang province. The China National Petroleum Corporation (CNPC) owns a significant stake in the Kashagan oil field in the Caspian Sea, while other Chinese companies own several key oil fields around the western city of Aktobe. In addition, Kazakhstan serves as key transit route for oil and gas from the smaller nations of Central Asia, assuring it a key role in the region's future energy landscape.

The 2014 cratering of the oil market, a product of geopolitics far beyond the steppe, hit Kazakhstan particularly hard. Oil production in Kazakhstan fell for the third consecutive year (-1.4 percent from 2015 to 2016) to 1.672 million barrels per day. Nonetheless, Kazakhstan remains one of the top producers in the Europe and Eurasia region, behind Russia and Norway and ahead of Azerbaijan<sup>53</sup>.

Natural gas production in Kazakhstan, an energy industry secondary to gas, is much more modest. At the same time, the country's natural gas production has grown consistently over the last several years, from 19.0 in 2015 to 19.9 billion cubic meters. Most of that was exported to Russia by pipeline, with a small amount (only 0.4 billion cubic meters) to China.

Turkmenistan is the region's main gas exporter, and exports directly to China through the Central Asia-China Gas Pipeline. Turkmenistan's insular nature and dependence on a single customer has seemed to finally be reflected in its gas production numbers. Natural gas production fell for the first time since 2009, from 69.6 to 66.8 billion cubic meters. An overwhelming majority of Turkmenistan's natural gas was exported in 2016 to China (29.4 billion cubic meters), followed by Iran (6.7 billion cubic meters) and

52. Energy and Geopolitics: China and Central Asia, Mehmet Ogutcu, Co-Authored With Xin Ma, Kazakhstan International Business Magazine №3, 2007 <http://www.investkz.com/en/journals/53/428.html>

53. Astana has been sly about oil production, making tacit promises to OPEC to cut back while also reveling in the revving up of production at Kashagan, which came online (again) last fall. Meanwhile, production has fallen at some of the older Kazakh fields, balancing some of the boom at Kashagan.

Kazakhstan (1.1 billion cubic meters). Turkmenistan exported 37.3 billion cubic meters of gas in 2016<sup>54</sup>. In the oil market, Turkmenistan has stagnated. Oil production from 2015 to 2016 remains unchanged at 261,000 barrels per day.

Uzbekistan is often described as resource rich, but it does not belong on the same plane as Turkmenistan with gas and Kazakhstan with oil. Uzbekistan, rather than being energy rich, should perhaps be described as energy diverse. Uzbekistan also supplies gas through the upgraded pipeline network and has attracted Chinese investment in recent years, typified by a \$15 billion bilateral energy deal concluded in 2013.

In terms of oil, Tashkent has seen steady decline in production over the past decade. Oil production in 2016 (55,000 barrels per day) is about half what it was in 2006 (114,000 barrels per day). Following global trends toward cleaner fuels, natural gas production jumped 8.4 percent between 2015 and 2016. Uzbekistan's natural gas exports are also more balanced than Turkmenistan's, with 1.5 billion cubic meters going to Kazakhstan, 5.0 billion cubic meters to Russia, and 4.3 billion cubic meters going to China.

Kazakhstan and Turkmenistan's reliance on oil and gas, respectively, ties their economies to the whims of those markets. Uzbekistan is a bit more insulated, if only because it is less dependent on oil and gas revenues.

China has financed two refineries in Kyrgyzstan, in the towns of Kara-Balta and Tomok. The refineries are supplied by CNPC-run oil fields in Kazakhstan, and produce 1.35 million tonnes of refined product annually.

This progress has evolved gradually over several years through a concerted attempt by China to develop the region's resources. Discussions of new infrastructure connecting Central Asia with its neighbours (such as power generation/transmission and oil and gas pipelines transmission) are inevitably shaped by opportunities for politically influential figures and groups to profit from them. In much of Central Asia, corruption and criminality are serious<sup>55</sup>. Investing in energy infrastructure, such as expanding oil and gas pipeline networks and building new power plants or transmission capabilities, has also been incorporated into China's broader silk road strategy<sup>56</sup>.

Likewise, a Chinese-funded oil refinery plant in Kyrgyzstan is going to break the Kremlin's fuel supply monopoly. The region is being re-wired so that all roads lead to China, and the economics are becoming increasingly dependent on China. The longer-term implications of this shift have yet to be completely understood.

China is not the only investor in Central Asian connectivity. Other countries, including Turkey, the US, and the EU have also made improving Eurasian connectivity a part of their foreign policy<sup>57</sup>. Multilateral financial institutions, such as the Asian Development Bank, the European Bank for Reconstruction and Development and the World Bank have long been investing in the region's infrastructure. The Kazakh government has its own \$9bn stimulus plan, directing money from its sovereign wealth fund to infrastructure investment.

54. Given Ashgabat's gas spat with Iran at the start of 2017 these figures are likely to worsen in next year's report. Turkmenistan lost Russia as a customer at the start of 2016. Consumption continues to rise in China, so demand remains for Turkmen gas, but not at the pace of previous years.

55. <http://web.stanford.edu/~ldiamond/papers/civJap.pdf>

56. Xiaojie Xu, "The Oil and Gas Links Between Central Asia and China: A Geopolitical Perspective", OPEC Review, Vol. XXIII No.1, March 1999, p.48.

57. <https://www.ft.com/content/ee5cf40a-15e5-11e6-9d98-00386a18e39d>

Meanwhile, overcapacities in China's domestic power sector have also given impetus to expanding overseas markets as a way to help keep domestic industries afloat and alleviate economic and social pressures at home. One key example is the coal sector, which is under strain as Beijing develops a campaign to reduce national coal consumption and increase the importance of natural gas and renewable energy. Building coal-fired power plants overseas is considered a way to provide new revenue streams and opportunities for Chinese labor abroad.

But overcapacities have also emerged in the renewable energy sectors of wind and solar as a result of expansionist supply-side policies<sup>58</sup>. BRI seems in part designed to help China export its production of wind turbines and solar cells by creating new markets for its products: China has regularly financed projects at low cost on the condition of supplying the beneficiary with its own technology. But the BRI labeling, focusing on mutual benefits and smooth trade diplomacy, will also help China avoid the pitfalls of trade sanctions and commercial battles that its PV industry has had to face since 2012.

The emphasis that the BRI concept places on "interconnectivity" in the energy sector also aims to facilitate regional economic development, providing opportunities both for China's border and inland provinces, and for countries in the region. By creating a vast network of interconnected energy infrastructure,

China looks to bolster some kind of commercial and diplomatic integration that can boost economic prosperity<sup>59</sup>. The network of pipelines, roads, railways and electric lines set to arise from the BRI project will be the materialization of these mutual economic and diplomatic interests that the initiative aims to foster.

While Chinese companies have excelled in mass production of standard energy technologies, their need for advanced knowhow is also a strong motivation for internationalization, as China seeks to achieve a broader transition towards higher value-added industries and a cleaner energy future. The BRI initiative provides the opportunity to access mature markets and partner with the flagship companies of the energy industry<sup>60</sup>. The number of energy projects officially labeled as BRI is increasing, but while there are some that are indeed new, many pre-existing projects have been retroactively subsumed into BRI. One way to assess BRI's direct contribution to Chinese investment activity overseas is to analyze those financed by BRI-linked financial institutions, such as the Asian Infrastructure Investment Bank and the Silk Road Fund<sup>61</sup>.

## Key messages

As the world's major hubs of population, production, trade and finance have shifted to the east, the global energy landscape must follow suit. China seeks energy security worldwide - Central Asia and Russia offer a viable, complementary source of additional supply in addition to what Beijing procures from the Middle East, Africa and Southeast Asia. Energy-investment-security nexus in the region is also a valuable contribution to China's strategic ambitions.

China is on the way to becoming the largest consumer of natural gas and oil from Central Asia. While

58. In wind energy, for instance, the pace of grid connection fails to follow the boost of installed capacity (+33% between 2015 and the first quarter of 2016), and in some northern regions like Inner Mongolia and Gansu, curtailment reaches up to 60% of production.

59. Can China Really Save Central Asian Economies?, Casey Michel, *The Diplomat*, February 13, 2016

60. Three years of China's new silk roads, from words to (re)action? Alice Ekman, Françoise Nicolas, John Seaman, Gabrielle Desarnaud, Tatiana Kastouéva-Jean, Serif Onur Bahçecik and Clélie Nallet, IFRI, February 2017

61. <http://thediplomat.com/2016/08/central-asias-oil-and-gas-now-flows-to-the-east/>

China's extensive investment in the region's energy infrastructure will undoubtedly grant it greater influence, it has also been vital and necessary in allowing this region to fulfill its long-held resource potential, placing it in a firm position to advance global energy security over the coming decades<sup>62</sup>.

China's overarching goal in Central Asia beyond securing natural resources is to ensure the region maintains a level of security and stability so China's own western marches become no more restive. It sees the best way of doing that as guiding Central Asia

Taken at face value, Chinese investments in Central Asia are indeed outstripping the United States, the European Union, and Russia. Because of the geographic distance in the case of the EU and America, or the shrinking population and lopsided economy of Russia, it is doubtful that any player will be able to match China on a dollar for dollar basis in the coming years. Yet, only on figures concerning outsized Chinese FDI and bi-lateral loan guarantees masks a much more complex dynamic. Moscow's security arrangements with Central Asia are more extensive and superior to those held by China, but when discussing energy and economic cooperation the headlines should be more circumspect. Furthermore, without the Russian controlled energy pipeline network, Central Asian states like Kazakhstan would be extremely hard pressed to transport its major commodities to market.

Contrary to the expectations, the West does not have any strong presence in the region. Russia and China seem to have the firing power in the east of Baku. Likewise, other Northeast Asian countries—Japan and Korea in particular—have now become increasingly engaged in the region for reasons of energy and geopolitical rebalancing<sup>63</sup>. Yet, Japan's Asian neighbors and trading partners still hold painful memories of its previous bid for military expansion and regional, if not global, dominion. Thus, in looking at Central Asia's external security, economic, political and environment, all the neighboring states have to be factored in as an element in the region's future, with varying degrees of power and influence<sup>64</sup>.

Ever since the Eurasian recession began in earnest — or, predating that, when it was clear that Russia's economic engine would stall under Vladimir Putin's third term — there has nonetheless been a source of hope for Central Asia's economies: China. On the backs of China's BRI platform, Beijing has stepped in to provide Central Asian economies with the necessary trade, transport, and internal investment to offset a reeling Russia and sinking hydrocarbon prices. For the past few years, China has stood as the region's economic trump card — a rising Chinese tide would, as the regional governments assumed, raise their fortunes as well<sup>65</sup>.

China takes different economic and geopolitical approaches towards Russia and the Central Asian producers. Compared to Russia, seen as relatively unreliable, Central Asian hydrocarbon resources seem more promising and feasible for China, although funding problems and political calculations plaguing all

62. <http://thediplomat.com/2016/08/central-asias-oil-and-gas-now-flows-to-the-east/>

63. Japan has become the largest donor country to Central Asia and, like China, sees the region—if it is stabilized and developed—as a potential market, source of raw materials, and bridge to the Middle East. And Korea has a more intimate relationship thanks to the distinct Korean populations deported there under Stalin, who have now become an influential social, political and economic component in Kazakhstan and Uzbekistan. Although China, Japan, and Korea, have only begun to make their presence felt, and their impact on trade and other regional issues has not yet been so substantial, in a sense Central Asia is rapidly becoming the heartland of Asia.

64. <https://www.brookings.edu/on-the-record/the-united-states-and-russia-in-central-asia-uzbekistan-tajikistan-afghanistan-pakistan-and-iran/>

65. Can China Really Save Central Asian Economies?, Casey Michel, The Diplomat, February 13, 2016

pipeline projects will offer no exception.<sup>66</sup> Furthermore, China's extending its Central Asian land routes from Kazakhstan and Turkmenistan and then down to northern Iran could create a visionary Sino-Arab oil passage to the Gulf ports<sup>67</sup>.

Central Asian power projects are also on the increase, In 2016, Kazakhstan generated 94.5 terawatt-hours, Turkmenistan 22.6 terawatt-hours, and Uzbekistan 58.9 terawatt-hours<sup>68</sup>. Covering an area of over 4 million square kilometers and sitting at the crossroads of East, South, and West Asia, the countries of Central Asia have for millennia been at the centre of the exchange of ideas, people, and technology. And today, the region's countries are sharing and collaborating to accelerate the deployment of renewable energy. Renewable energy is not only for helping the region with the imperative to modernise its energy system and to meet the goals of the Paris Agreement, but also releasing more oil and gas for exports<sup>69</sup>.

The energy corridors from Central Asia to China, Russia to South Asia and to Europe and the Gulf countries could eventually position the "Middle Kingdom" at the center of a «Pan-Asian Global Energy Bridge» that will connect existing and potential suppliers to Asia (i.e., the Middle East, Central Asia, and Russia) with the key consumers (China, Japan and Korea). If successfully implemented, such linkages will not only largely improve the energy security of China, but also will enhance its geopolitical influence and trade in this geography as well as boosting the global energy security.

They all mean in return increased economic interdependencies, reduced security risks and greater business opportunities.

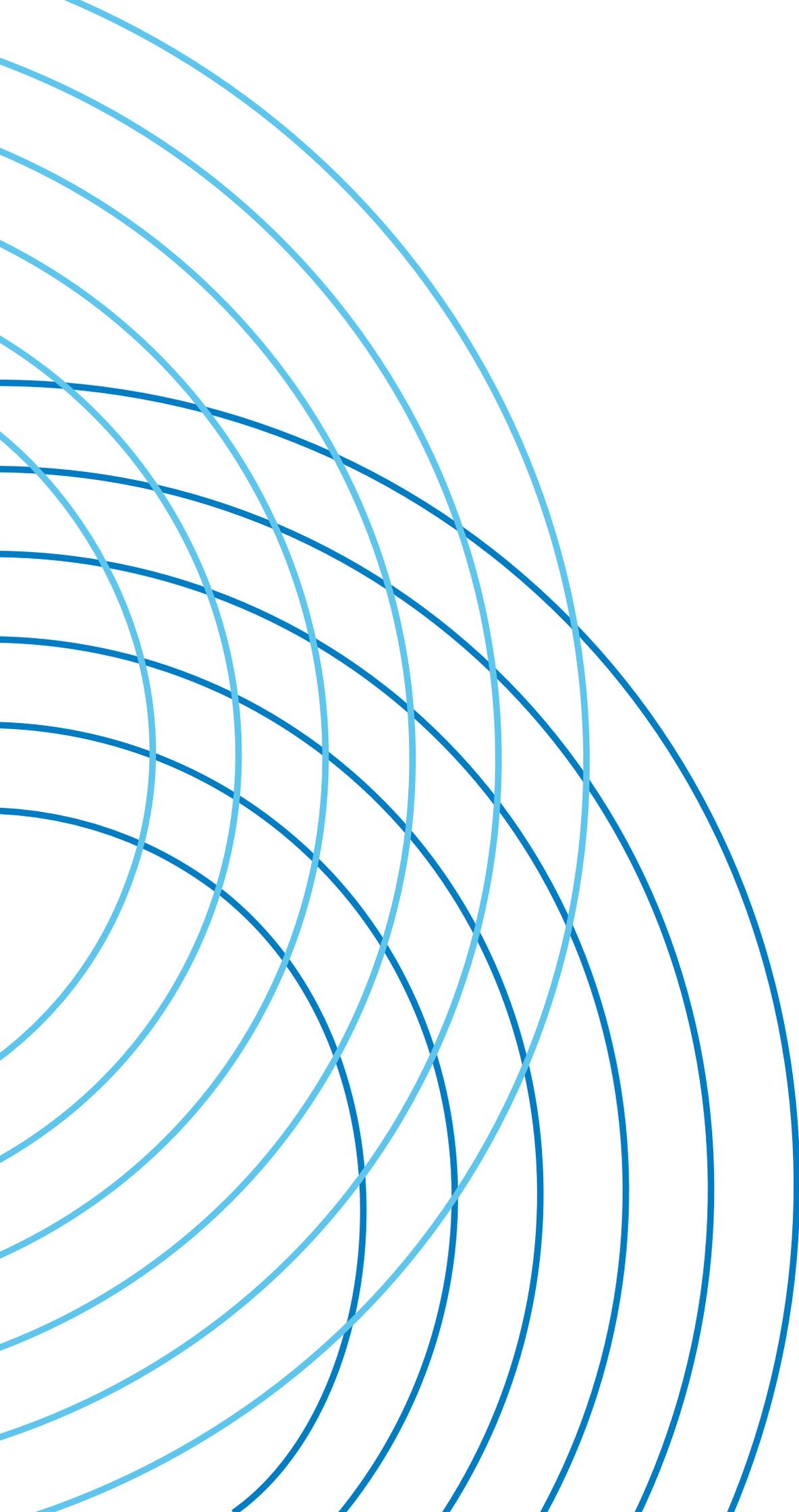
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66. G. Kemp, R. Harkavy, *Strategic Geography and the Changing Middle East* (Washington, DC: Carnegie Endowment for International Peace, 1997), p. 131.

67. Xiaojie Xu, "The Oil and Gas Links Between Central Asia and China: A Geopolitical Perspective", *OPEC Review*, Vol. XXIII No.1, March 1999, p.48.

68. <http://thediplomat.com/2017/06/energy-in-central-asia-who-has-what/>

69. The first wind generator production facility in Central Asia is set to kick off by the end of 2017 in Aktobe, Kazakhstan. Construction will last about three years with the maximum production capacity of the plant reaching 250 megawatts a year at the cost of €84 million.







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