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CHINA-CENTRAL ASIA NEIGHBORHOOD COMPLEX INTERDEPENDENCE. NEW ENERGY ARCHITECTURE AND THE SILK ROAD ECONOMIC BELT SUSTAINABILITY

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CONTENTS

ABSTRACT

China as an assertive regional player is developing complex system of neighborhood interdependence with Central Asia within the framework of the Silk Road Economic Belt. New energy architecture indicates the region's evolving role from the supplementary source of natural resources to complementarity aimed to facilitate mutual economic growth and sustainability.

INTRODUCTION

China as an assertive regional player is developing complex system of neighborhood interdependence that would facilitate its continuous economic growth. From this perspective Central Asian region could be seen as having core position in the system of complementary development based on the Western China Development Strategy and the Silk Road Economic Belt.

The role of the region cannot be seen simply limited to the supplementary source of natural resources or part of the transport corridor. It shall be seen as integral part of the future matrix of interdependency. Such potential role could be especially identified in regional energy security architecture. China is an active player in the upstream petroleum industry in Central Asian countries. It is diversifying its energy supply with direct oil and gas import from the region by building transnational pipelines (the Kazakhstan–China oil pipeline, the Central Asia–China gas pipeline). Furthermore, China is also being increasingly involved in the downstream petroleum industry (e.g. the China Petrol Company Zhongda's investment in the Petroleum Refinery "Zhongda" in Kara-Balta, or the construction of the petroleum refinery in Tokmok by the Xinjiang International Trade and Industry Company – both cities located in Kyrgyzstan).

Furthermore, Chinese companies are increasingly involved in power transmission projects. In 2015, Tebian Electric Apparatus (TBEA) completed the construction of Datka-Kemin 500 kV Transmission Line. The project was called by then Kyrgyz president Almazbek Atambayev as "the project of the century" that supports Kyrgyzstan's sustainable development. Moreover, Chinese companies are eyeing the Central Asia South Asia Electricity Transmission and Trade (CASA-1000). Project designed to transmit surplus electricity from Tajikistan and Kyrgyzstan to Afghanistan and Pakistan.

Thus, Chinese involvement in energy project has comprehensive character that shapes new energy architecture supporting its economic power inside and outside the country. Such moves could be contextualized in the process of moving manufacturing to secure investment zones in close neighborhood and framed in the good neighborhood policy.

Even more broadly, the neighborhood policy of China towards Central Asia shall be contextualized into Chinese President Xi Jinping idea of "community of shared future for mankind" or "community of common destiny" that was first voiced in his speech at the United Nations Office at Geneva on 18 January 2018 [1] and once again highlighted in the report "Secure a Decisive Victory in Building a Moderately Prosperous Society in All Respects and Strive for the Great Success of Socialism with Chinese Characteristics for a New Era" delivered at the 19th National Congress of the Communist Party of China on 18 October 2017. In the report he described the community of common destiny based on "the path of peaceful development", mutually beneficial strategy of opening up", "common, comprehensive, cooperative, and sustainable security", and "innovative, and inclusive development that benefits everyone".[2]

RESEARCH TASK: CHINA'S NEW NEIGHBORHOOD POLICY AND INVESTMENT BLUEPRINT IN CENTRAL ASIA

The research looks at Chinese investment in the region with special focus on Kyrgyzstan and Tajikistan to identify links between various types of investments (industrial zones, mining, transport and energy infrastructure) to wider Chinese strategy. Those two country cases allow to draw picture of growing neighborhood interdependence between China and Central Asia within the framework of the Silk Road Economic Belt. The special focus is made to draw prospects for energy architecture in wider regional development agenda and its long-term sustainability in line with new China's neighborhood policy.

Accordingly, in 2013 China declared new policy towards its neighborhood including Central Asia. President of China and Communist Party chief Xi Jinping in his speech "Work together to build the Silk Road Economic Belt" made in August 2013 during his visit in Kazakhstan set five specific areas that must be taken into consideration to enhance cooperation between the region and China. Those are: policy consultation laying the foundations for regional economic integrations, improvement of road connections, promotion of unimpeded trade, enhancement of monetary circulation, improvement of understanding between peoples as solid social foundation for regional cooperation.[3]

Following, the new general format of regional relations was defined in October 2013, during the Neighborhood Diplomacy Work Conference organized by the Central Committee of the Communist Party of China. On 24th October 2013 Party chief Xi Jinping in his speech "Diplomacy with neigbouring countries characterized by friendship, reciprocity, and inclusiveness" underlined that cooperation with neighbors shall be made on the basis of reciprocity – creation of complex dependency based on mutual interest in development of China and neighborhood.[4]

These statements may seem idealistic. However, they constitute the basis for an extremely pragmatic policy aimed at achieving the maximum benefits from the neighborhood. Firstly, Central Asian region could be seen as having core position in the system of complementary development of Western China. The region is natural partner in economic development due to its geographical proximity and also its underdevelopment including cheap labor force that makes favorable conditions for manufacturing relocation. Secondly, China's security interest is in stable neighborhood that minimizes eventual risk of any conflict spillover coming from Central Asia. Thus, China's engagement with such countries as Tajikistan or Kyrgyzstan could be framed as conflict prevention strategy through economic development. It must be underlined that investment risks in Central Asia are still significant due to fragile socio-political environment. Thus, comprehensive development and "solid social foundation" are necessary to secure stability for long-term investments. Therefore, China's involvement in the region must provide comprehensive development and some sort of social responsibility for its own good.

China's security interest is in stable neighborhood that minimizes eventual risk of any conflict spillover coming from Central Asia.

CHINESE INVESTMENTS AND REGIONAL PRODUCTION CHAINS

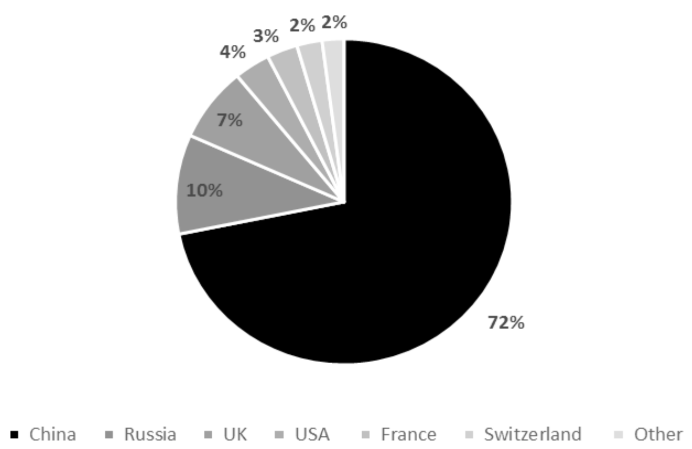
For the last five years China is unquestioned leader in foreign direct investment (FDI) in Tajikistan. In 2015 China provided 58% (272,6 mln USD) of the total amount of FDI, accordingly 50% in 2014, and 48% in 2013.[5] Only for the first three quarters of 2016 China provided 71,7% (255 mln USD) of total FDI.[6] Followingly, in the first half of 2017 Chinese investments equaled to 47,3% of total FDI, with Russia being second with 31,3%.[7]

Figure 1 Foreign Direct Investment (FDI) in Tajikistan (2016), by country in mln USD

Country:	mln USD	Percentage in Total FDI
China	***255,0***	***71,8%***
Russia	35,0	9,9%
UK	26,2	7,4%
USA	12,3	3,5%
France	10,5	3,0%
Switzerland	8,6	2,4%
Other	7,4	2,1%
Total:	355,0	**100,0%**

Data Source: State Committee on Investments and Management of State Property of the Republic of Tajikistan
Annotation: Data for first three quarters of 2016.

Figure 2 Structure of Foreign Direct Investment (FDI) in Tajikistan (2016)



Data Source: State Committee on Investments and Management of State Property of the Republic of Tajikistan.
Annotation: Data for first three quarters of 2016.

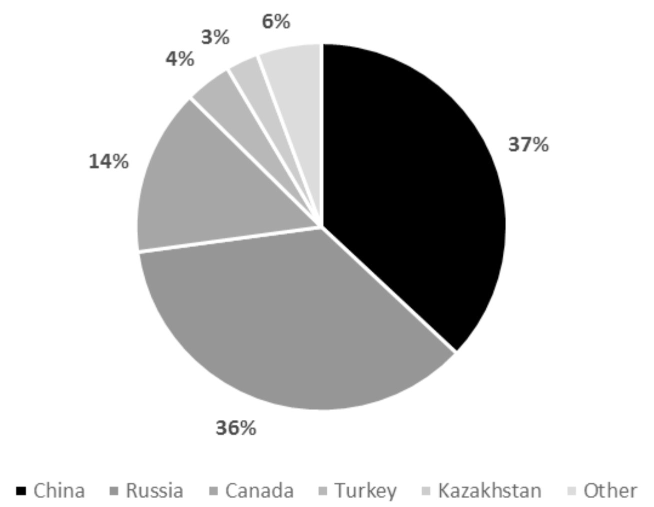
Similarly, China plays important role in providing FDI to Kyrgyzstan. In 2016 China was ranked first with delivering 301,3 mln USD (37%) of 813,96 mln USD total FDI. Moreover, it shall be ranked as first foreign investor (according to FDI) since Kyrgyzstan gained its independence in 1991. Between 1994-2016 China provided 2,014 bln USD (20,5%), narrowly overtaking Canada with 1,912 bln USD (19,5%).[8]

Figure 3 Foreign Direct Investment (FDI) in Kyrgyzstan (2016), by country, in mln USD

Country:	mln USD	Percentage in Total FDI
China	***301,30***	***37,0%***
Russia	291,54	35,8%
Canada	118,89	14,6%
Turkey	33,24	4,1%
Kazakhstan	23,11	2,8%
Other	45,88	5,6%
Total	**813,96**	**100%**

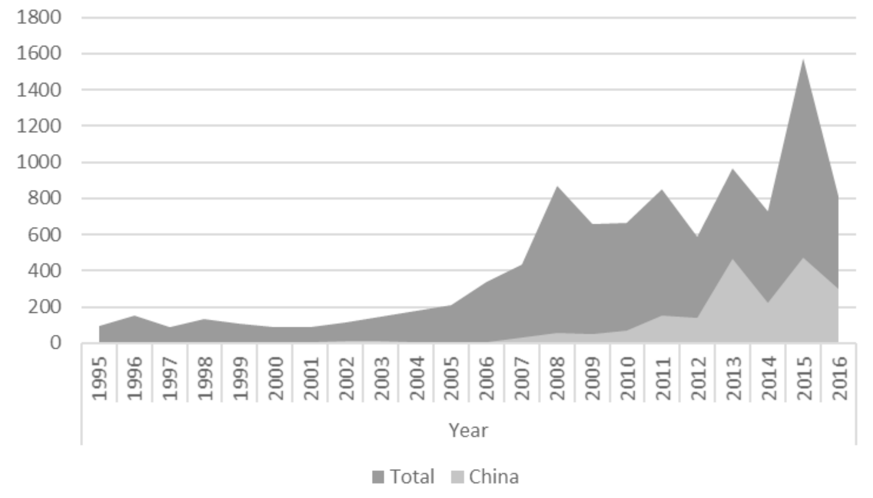
Data Source: National Statistics Committee of the Kyrgyz Republic

Figure 4 Structure of Foreign Direct Investment (FDI) in Kyrgyzstan (2016)



Data Source: National Statistics Committee of the Kyrgyz Republic

Figure 5 Foreign Direct Investment (FDI) and Chinese FDI in Kyrgyzstan (1995 - 2016)



Data Source: National Statistics Committee of the Kyrgyz Republic

China-Tajikistan cooperation is characterized by rapidly growing involvement of Chinese companies in development of new production facilities, particularly within special economic zones. For example, in September 2014 the Memorandum on cooperation on the project "Industrial area of Tajikistan and China" (IATC) between the Ministry of Industry and New Technologies of the Republic of Tajikistan and "Tachen International Company of XUAR Resource" was signed. The agreement encompasses exploration and mining of polymetallic deposit ores «North Zarnisor» and construction of industrial zone in Istiklol town.[9] Accordingly, IATC would stretch over an area of 70 hectares. Chinese investor pledged to invest 500 mln USD in the establishment of the zone almost. The main enterprise of IATC would be metallurgical plant with capacity to process up to 100 tons of lead per year. Its operation would begin in 2017 and provide jobs for 2000 people. In addition to metallurgical plant there are plans to build six more factories within IATC including cement one.[10]

Chinese investor pledged to invest 500 mln USD in the establishment of the zone almost.

As of the beginning of 2018 main elements of IATC are functional. In November 2017 Tajikistan's President Emomali Rakhmon officially opened new metallurgical plant with capacity to process up to 50 000 tons of lead per year and underlined further development of production capacity of the industrial zone in Istikol.[11]

Similarly, Kyrgyzstan is accelerating work towards establishment of industrial zones. On 29th January 2016, deputy minister of economy of Kyrgyzstan Danyar Imanaliyev confirmed that such zones are part of anti-crisis measures.[12] Chinese involvement in creation of such zones is in line with declared priorities in China-Kyrgyzstan cooperation. On 12th January 2016, then Prime Minister of the Kyrgyz Republic Temir Sariyev announced three priorities of Chinese-Kyrgyz cooperation: construction of China-Kyrgyzstan-Uzbekistan Railroad (CKUR), construction of ring road around Issyk-Kul lake, and manufacturing relocation from China to Kyrgyzstan. [13]. In line with the above in May 2016 Kyrgyz Foreign Minister handed the list of 40 investment proposals for Chinese counterpart.[14]

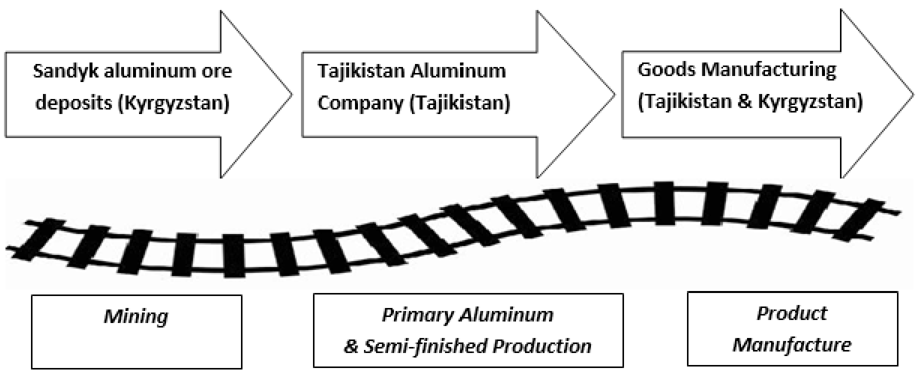
There is no doubt that the new railway will significantly increase industrial development opportunities including manufacturing relocation. The new rail link from Xinjiang region to Uzbekistan across the territory of Kyrgyzstan would not only improve regional connectivity but it would improve access to natural resources along the planned route. [15]. Additionally, CKUR's impact shall be assessed in conjunction with the planned China-Kyrgyzstan-Tajikistan-Afghanistan-Iran railway (CKTAIR). Both railway projects received additional political impetus after the removal of sanctions on Iran and when Shavkat Mirziyoyev became President of Uzbekistan in 2016.

New railway network could integrate economies of Tajikistan and Kyrgyzstan in a new way. Tajikistan's largest factory and main exporter is the state-owned Tajikistan Aluminum Company (Talco). There are no domestic supplies of aluminum ore. Thus, Talco totally relies on import. [16] Subsequently, mineral deposits in Kyrgyzstan include aluminum ores represented by nepheline syenites at the Sandyk (203.4 mln tons of aluminum trioxide (Al2O3) which contains 20% aluminum) and Zardalek deposits (200.5 mln Al2O3) which contains 20% aluminum).[17] It shall be noted that there were speculations that China offered to finance construction of CKUR in exchange for resources including the Sandyk aluminum deposit. [18]

New railway network could integrate economies of Tajikistan and Kyrgyzstan in a new way

Development of Kyrgyz aluminum deposits could secure Talco with raw material. Furthermore, the case could serve as an example of possible setup of efficient regional production chain. In complex mutual development of both countries, all phases of production cycle could be established – from mining, primary and semi-production to product manufacture. Regional sourcing could be advantage-helping manufacturers to save cost and new railways secure access to world market.

Figure 6 Aluminum - Regional Production Chain (Kyrgyzstan & Tajikistan)



CHINA'S INVESTMENT IN GAS&OIL INDUSTRY

In comprehensive development of Central Asia formation of stable energy supply including oil and gas cannot be underestimated. Chinese oil and gas pipelines projects are mostly based on motivation to diversify energy supply for its economy with direct import from the region. However, China backed pipelines could be seen as supportive to energy security of Tajikistan and Kyrgyzstan. The development shall also be analyzed in the context of China's engagement in the downstream oil and gas industry in those countries.

China's Central Asia Gas Pipeline (CAGP) includes four branches starting in Turkmenistan. First three branches (A, B, C) runs through Uzbekistan and Kazakhstan before reaching China. Unlike the first three branches of the CAGP, Line D will bypass Kazakhstan, taking a southern track through Uzbekistan, Tajikistan and Kyrgyzstan.[19] New pipeline could be potentially used as an alternative source of natural gas. Both countries hesitate to confirm supplementary role of CAGP to development of national gas markets. However, potential of CAGP in diversification of natural gas source cannot be underestimated.

New pipeline could be potentially used as an alternative source of natural gas.

China's energy infrastructures include also the Kazakhstan–China oil pipeline. The project has primary role to provide access to Central Asian crude oil. There is possibility to expand pipeline with "southern link" to Chinese Zhongda's refinery in Kara-Balta (Kyrgyzstan).[20] However, such possibility is still hypothetical and up to now refinery relies on rail delivery of Russian oil.

It shall be underlined that import from both Russia and Kazakhstan including hypothetical "southern link" has certain disadvantage. Disagreement related to crude oil import from those directions led to situation when Kyrgyzstan recurrently suffered from deficit of crude and oil products. According to official statement in September 2015 "Zhongda" refinery used only 10% of its installed capacity.[21] Comparable difficulties are affecting the petroleum refinery in Tokmok operated by the Xinjiang International Trade and Industry Company.

It shall be noticed Kyrgyzstan's crude oil and oil product market was partially stabilized due to 2016 agreement with Russia on tax-free supply of oil and oil products.[22] In line with the agreement Russia agreed to deliver 1,470 mln tons oil and oil products in 2017, including 450 thousands tons of crude oil, 560 thousands tons of gasoline and, 460 thousands tons of diesel fuel.[23] Analogically, Russia agreed to deliver 1,295 mln tons oil and oil products in 2018, including 450 thousands tons of crude oil, 410 thousands tons of gasoline and, 335 thousands tons of diesel fuel.[24]

The role of Russian oil and oil products deliveries for stabilization of Kyrgyz economy shall not be underestimated. However, they could not be seen as the only solution and long-term guarantee. The imposition of trade blockade by Kazakhstan on Kyrgyzstan in October 2017 again confirmed unreliability of delivery route via this country and overshadowed potential advantages, including those presented by the potential of “southern link”. The blockade was lifted in December 2017 after talks between Kazakh President Nursultan Nazarbayev and new Kyrgyz President Sooronbay Jeenbekov However, there are no guarantees that similar situation would not occur again as even in this case its Eurasian Economic Union (EEU) proved to be ineffective. Thus, in Kyrgyzstan the search for alternatives to Kazakh route and thus acceleration of cooperation with China could be seen pure raison d’État.[25]

The need to diversify crude oil deliveries cannot be ignored. It shall be noted that “Zhongda” refinery is technologically able to reprocess different sort of crude oil.[26] Thus, there is prospect that Kazakh or Russian crude oil would be replaced with crude oil of different origin. Enormous potential for crude oil deliveries could be seen again in railway network development including CKUR or CKTAIR. Both railways could potentially provide access to crude oil from Iran. Thus, oil product market in Kyrgyzstan could be stabilized.

Similarly, in case of Tajikistan CKTAIR could play important role in crude oil import diversification. Chinese companies are active in developing petroleum industry. In example, Chinese company Dong Ying Heli Investment and Development Co. Ltd is currently engaged in construction of new refinery in the Danghara free economic zone in Khatlon Province.[27] As of the beginning of 2018 the refinery is ready for operation and currently negotiations with crude oil suppliers including the Islamic Republic of Iran are ongoing.[28]

As of the beginning of 2018 the refinery is ready for operation and currently negotiations with crude oil suppliers including the Islamic Republic of Iran are ongoing.

The transport infrastructure shall be seen as a supportive element of the downstream oil industry development in Tajikistan. However, primary Chinese involvement and important development driver could be identified in the development of local source of oil. Thus, in 2012 China pledged to invest almost 1 bln USD in gas and oil exploration projects in Tajikistan. [29]

China is also present in Kyrgyzstan upstream oil industry where Chinese investors fully or partially control some of leading oil exploration and production companies such as CJSC Textonik (Russian: ЗАО «Текстоник»), South Derrick LLC (Russian: ОсОО Южный Деррик) or OJSC Batkenneftegaz (Russian: ОАО Баткеннефтегаз).[30][31]

CHINA'S ENGAGEMENT IN ELECTRIC ENERGY POTENTIAL DEVELOPMENT OF KYRGYZSTAN AND TAJIKISTAN

Involvement in development of electricity production and transportation in Central Asia could be framed as supportive to Chinese goals both within region, as well as in other areas. One of China's aim could be seen in establishment of a Central Asia - South Asia Regional Electricity Market (CASAREM). The cornerstone of the project is the development of the 1000 Electricity Transmission and Trade Project for Central Asia and South Asia (CASA-1000) that could create sustainable electricity trade between potential suppliers (Central Asian countries of Kyrgyz Republic and Tajikistan) and countries facing electricity shortages (the South Asian countries of Afghanistan and Pakistan).

The rationality of the project is based on substantial hydropower potential of Tajikistan and Kyrgyzstan that is still underdeveloped. Tajikistan estimates its potential at 527 billion kWh per year, which is only used at the level of 5%.[32] Kyrgyzstan estimates its hydropower potential at 142.5 billion kWh per year, which is only used at the level of 8-9.5%. [33]

Currently, electricity generation in Tajikistan is dominated by hydropower with essential position of the largest hydroelectric power plant of Central Asia - Nurek HPP with installed capacity of 3,015 MW and responsible for producing over 70% of nation's electricity.[34] Other large HPP with installed capacity equal or over 30 MW include Baipaza HPP (600 MW) completed in 1985, Kairakkum HPP (126 MW) completed in 1956, Sarband HPP (240 MW) in 1962, Sharshara HPP (30 MW) completed in 1958, Sangtuda 1 (670 MW) completed in 2009 and Sangtuda 2 (220 MW) completed in 2011.[35] However, Tajikistan frequently suffers from electricity shortages with previously mentioned Talco using about 40% of total electricity consumption.[36] Thus, present capacity does not allow for sustainable electricity export. However, the country could turn into a net export potential only with construction of the Rogun HPP with capacity of 3600 MW. Nevertheless, the Rogun HPP is highly controversial due to opposition from neighboring Uzbekistan. Official authorities of this country stress potential hazards associated with high seismic activity in the areas of construction and interruption of the flow of the Vaksh River, one of the sources of the Amu Darya, and, consequently, would deeper water deficit in downstream countries.[37] Despite continuous opposition from Uzbekistan, Tajik authorities underlines the necessity of the project and continues construction. Furthermore, Tajikistan underlines that negative impact on the flow of the Amu Darya would be limited as the filling of reservoir would take 10 years.[38] In October 2016 Tajikistan accelerated construction of the Rogun HPP. It is planned that first phase of the construction would be finished in 2018.[39] Experts of the Eurasian Development Bank (EDB) indicates that the normalization

China's aim could be seen in establishment of a Central Asia - South Asia Regional Electricity Market (CASAREM).

of relation between Tajikistan and Uzbekistan would allow to finish the project.[40] In fact Uzbekistan under new leadership refrained from criticism of the project that was close to war rhetoric and moved towards more cooperative tone.

HPP projects in Kyrgyzstan face similar protest from Uzbekistan. Almost 40% of domestic electricity production in Kyrgyzstan relies on HPP Toktogul (1200 MW). The project was completed in 1975. The Toktogul cascade is supplemented with another large HPP – Kurpsai (800 MW) completed in 1981.[41] Both projects demand rehabilitation which is underlined with recurring technical breakdowns as in December 2015.[42] Comparably to Tajikistan, current development of hydropower generation does not even meet domestic needs.

However, Kyrgyzstan also possesses huge hydropower potential that could be developed. Flagman projects includes construction of Upper Naryn cascade and the Kambar-Ata-1 HPP. The cascade would include four HPPs (191MW): Naryn HPP-1, Naryn HPP-2, Naryn HPP-3 and Ahbulinskya HPP.[43]

The cascade allows to regulate water flow and allows for better functioning of the Kambar-Ata-1 HPP. The last one with proposed capacity of 1900 MW plays analogous role for Kyrgyzstan as the Roghun HPP for Tajikistan. It would allow the country to turn into electricity exporter.

However, the development of Kyrgyz projects were delayed due political unrest of 2005 and 2010. Furthermore, in the beginning of 2016 Kyrgyzstan denounced Russian-Kyrgyz agreement on the construction of Upper Naryn cascade and the Kambar-Ata-1 HPP. The decision was based on Russian inability to further finance projects. Nevertheless, there is potential that Kyrgyz HPPs could be financed with Chinese Silk Belt Road Initiative, with participation of the Asian Infrastructure Investment Bank (AIIB) or the Silk Road Fund. [44]

The development of hydro electricity production could be in line with new Chinese neighborhood policy. With new projects, Kyrgyzstan and Tajikistan would provide foundations for such projects as CASA-1000 and CASAREM. Thus, they would secure Chinese manufacturing relocation to such countries as Pakistan. Moreover, they would provide basis for sustainable development in Central Asia as energy shortages negatively impact socio-political conditions of both countries.

The development of hydro electricity production could be in line with new Chinese neighborhood policy.

To contextualize possible Chinese involvement in hydro electricity production in those countries it is necessary to see seasonal characteristic of hydropower generation. Export could be possible with summer surpluses, while winter shortfalls shall be covered by local production or import. Concerning local production, China's potential in development of power generation from coal shall be mentioned. In example, there is a huge potential of China involvement in development of small coal-fired power plant in Kyrgyzstan that would be built near coal mines. [45]

SUMMARY

The above-mentioned examples of cooperation and arguments for further development in energy sector between China and Central Asian states as Kyrgyzstan and Tajikistan are the examples of practical embodiment of the Silk Road Economic Belt initiative and Good neighborhood policy of China.

Surely, there is certain level of criticism regarding growing China's presence in the region, both constructive, and also that based on emotionally saturated frames explored by interest groups/lobbies interested to undermine One Belt and One Road Initiative (OBOR) in general or particular projects as CKUR.

Therefore, in order to avoid the social discontent that can be raised by media, concerned parties, the governments of Kyrgyzstan and Tajikistan should continue the integration processes with China within the framework of OBOR, and keep the national interests at the top. As the result, the complementary and mutually beneficial cooperation between China and Kyrgyzstan, and Tajikistan would lead to wider regional development and its long-term sustainability.

It shall be noted that both countries shall try to move from old politico-economic paradigms – improve governance and re-evaluate its geo-economic position to seek maximum gains from such cooperation. For example, among such developments could be seen the development of infrastructural project Digital CASA in Central Asia that would technologically advance the region[46], or the move to adopt standard-gauge railway (1,435 mm)[47]. Thus, there are many opportunities that shall be carefully investigated but not delayed.

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