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The risks to China's

Silk Road Economic Belt.

Double-Edged Sword

BY FRIEDRICH WU, VIDHYA LOGENDRAN AND WAN TIN WAI

China means business when it comes to the Silk Road Economic Belt and Maritime Silk Road. That was evident at the Boao Forum in March where President Xi Jinping delivered a keynote address providing the first in-depth explanation of China's vision for the Belt and Road Initiative. Envisaged as both a network of physical infrastructure such as railways, highways, oil and gas pipelines, and power grids, as well as a facilitator of greater trade and financial integration, China foresees the Belt and Road Initiative feeding the demand for infrastructure investment and fostering greater growth in Asia, Africa, and even Europe.

Of course, China would reap benefits from this bold initiative, too. The Chinese implemented a "Going Out" strategy in 1999 to complement their country's stellar inward foreign direct investment-driven economic growth. In fact, China is expected to be a net exporter of foreign direct investment in 2015, not unexpected for the world's second-largest economy holding the world's largest official foreign exchange reserves. Yet China faces some formidable domestic economic challenges, one being the uneven development between its coastal and inner regions, especially the western provinces of Xinjiang and Tibet. Indeed, the Silk Road Economic Belt would provide new impetus for China's western development strategy

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and create new opportunities for accelerating the economic transformation of the country.

China has already been building trade and investment linkages with the Central Asian republics since their independence in 1990. Yet doubts persist as to whether China would succeed with the overland vision of the Silk Road Economic Belt, particularly when faced with headwinds of extremism in a region characterized by latent ethnic conflict, porous borders, and shaky regimes. Bilahari Kausikan, Singapore's ambassador-at-large, claimed recently that the Chinese initiative might fail in Central Asia because "it is building on the very treacherous sands of intrinsically unstable regimes." What lessons can China learn from its experience in Central Asia thus far as it embarks on its ambitious Silk Road Economic Belt?

HOW CHINESE BUCKS GET THE BIGGEST BANG IN CENTRAL ASIA

It was China's thirst for energy that first drove it to the Central Asian republics both through investment and also trade, where China quickly became the largest trading partner for all the Central Asian republics except Uzbekistan. China imported oil and gas from the natural resource-rich countries such as Kazakhstan and Turkmenistan. Turkmenistan is China's largest foreign source of natural gas, accounting for over 52 percent of Chinese imports in 2013, and in turn, China has replaced Russia as the biggest market for Turkmeni gas. Kazakhstan is the region's largest oil supplier to China, accounting for 4 percent of China's total crude petroleum imports in 2013.

By investing in oilfields and pipeline infrastructure such as the China-Central Asia pipeline, China has helped reduce the reliance of Central Asian republics on the legacy of Soviet-era pipelines and diversified their energy exports. China National Petroleum Corporation is the majority owner of two of Kazakhstan's major oil companies (it owns 85.42 percent of AktobeMunaiGas and 67 percent of PetroKazakhstan) and is involved in several oil exploration and production projects throughout the country, accounting for about 25 percent of Kazakhstan's oil production.

Moreover, trade with the Central Asian republics is closely tied to the Xinjiang region, where China seeks to counter increasing unrest with accelerated investment and generous economic subsidies. Two-thirds of the trade between China and Kazakhstan, for example, consists of trade with Xinjiang, while 49 percent of investments from China were by Xinjiang-based companies.

How has China been able to gain traction in Central Asia? China has used government-to-government mechanisms and the Shanghai Cooperation Organisation for

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advancing its economic influence. State-owned enterprises have been able to parlay this influence into business wins. For example, in 2013, the Kazakh government used its preemptive rights to buy an 8.33 percent stake in the Kashagan oil project, which it then sold to China National Petroleum Corporation, thereby blocking a proposed sale to India's Oil and Natural Gas Corp. Another factor facilitating China's success in Kazakhstan is the acceptance of the Kazakh government's stipulation that all Chinese investments must involve the Kazakh national oil company, KazMunaiGaz. China often sweetens deals by offering loans and aid to the Kazakh government so that it may purchase stakes in these Chinese investments, like in the case of the 2009 purchase of MangistauMunai Gas where China National Petroleum Corporation provided KazMunaiGaz a loan of U.S. \$5 billion to secure 51 percent of the company while China National Petroleum Corporation itself retained 49 percent. China is a major source of money and a benefactor, but has refrained from interfering in these countries' internal politics, a practice it is likely to continue with the Belt and Road Initiative. It differs markedly from Russia, which often seeks political concessions in return for financial support, or the West, particularly the United States and the European Union, which often place conditions on funding.

POTENTIAL SPEEDBUMPS ALONG THE SILK ROAD

But Chinese investment in Central Asia has been a double-edged sword. Chinese transactions are often shrouded in secrecy, executed through forging links with the political elite, thus stirring up the suspicions of both lower-level bureaucrats and concerned citizens in the host countries. Chinese enterprises are also often criticized for their poor labor conditions, unfair pay, abuse of local workers, and unsustainable environmental practices, leading to protests and even violence against them. In October 2012, the head of the Chinese Chamber of Commerce in Kyrgyzstan, Li Deming, wrote in a state-run Chinese media outlet that doing business in Kyrgyzstan was "not easy." This was after 250 Chinese workers from China's Superb Pacific Limited were forced to flee operations at the Taldy-Bulak Levoberezhnyi gold field after a protest

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by Kyrgyz workers against mistreatment and environmental degradation turned violent. In 2013, Kazakhstan fined China National Petroleum Corporation U.S. \$50 million for numerous environmental violations. In late 2013, China financed the construction of Kyrgyzstan's first oil refinery, ending that country's complete dependence on Russian oil. However, by early 2014, work on the refinery was suspended by the Kyrgyz prime minister after local protestors demanded that the polluting plant clean up its act.

China's win-win proposition for the Belt and Road Initiative notwithstanding, it is likely to face similar resistance across the region. As such, China has to quickly learn to deploy soft power together with hard cash to smooth its way. South Korea has also built close trade relations with Central Asia in the last decade in search of new energy sources, but is viewed as less threatening by the Central Asian economies because of its strategy of a broader-based engagement with the region which has resulted in investment in healthcare, retail, automobile,

and high-technology sectors. South Korean automobile companies Ssangyong and Hyundai have built assembly plants in Kazakhstan. A Korean-Kazakhstani Technology Cooperation Center has been established to promote cooperation among Kazakhstani and South Korean companies and research institutions through joint research and development, training, and other projects. A recent report by the Asia Society states that "Beijing should think about expanding its cultural and philanthropic activities in Central Asia, facilitating educational exchanges, and investing in projects outside of the energy sector." Unsurprisingly, China's recently concluded deals with Kazakhstan to the tune of U.S. \$23.6 billion involve the steel, non-ferrous metals, sheet glass, oil refining, hydropower, and automobile industries, showing China's resolve to broaden engagement with Central Asian economies. Beijing also needs to encourage dissemination of Chinese cultural power by popularizing Chinese language, arts, and heritage. However, perceived threats of Sinicization together with China's preponderant

economic clout make this an onerous task, especially when cultural influences are disseminated through state channels. In this regard too, South Korea seems to enjoy an edge with the putative popularity of K-pop and Korean drama in Central Asia.

GEOPOLITICAL CONSIDERATIONS

Two main risks stare China in the face as it charges ahead with the Silk Road Economic Belt. Despite outward stability, many Central Asian regimes mask fractious societies, with rising income inequalities, endemic corruption, and latent ethnic tensions. Kyrgyzstan is the only Central Asian republic with a fragile parliamentary democracy, while authoritarian presidents rule all the other republics. Regime change in all the republics is likely to be fraught with political instability, which may threaten Chinese business interests. In recent years, newly elected governments from Sri Lanka to Greece have sought to gain popular legitimacy by often raising the specter of the Chinese economic bogeyman.

Some Central Asian republics have also shown a tendency toward cultivating other powers in or outside the region as a countervail, despite welcoming Chinese invest-

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ment with open arms, as they do not want to “exchange Russian dominance for Chinese dominance,” according to Niklas Swanström, director of the Institute for Security and Development Policy in Sweden. Central Asian republics also actively engage the European Union bilaterally to diversify their trade markets and investment sources.

Islamist influence on Uighurs in the Xinjiang region is already a problem that China seems to be at a loss to deal with effectively. In the past, China had relied on expeditious resolution of border disputes under the aegis of the Shanghai Cooperation Organisation and its economic diplomacy to gain the cooperation of Central

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Asian governments such as Kazakhstan to curb support for Chinese Uighur separatist activities from their local Uighur communities. The Silk Road Economic Belt, however, is envisaged as connecting China intricately with the Middle East through a largely Muslim Central Asian conduit, where indigenous Islamist movements such as the East Turkestan Liberation Organization and Islamic Movement of Uzbekistan also fester. Roads, as they say, run both ways. China would be forced to deal not only with potentially emboldened separatists in Xinjiang but also with the security threats that their investments may face from terrorist groups. China’s foreign policy orientation of non-interference in domestic affairs and the pursuit of a “peaceful periphery” may both be severely challenged, demanding more aggressive diplomatic or military responses which would contravene Beijing’s hitherto non-interventionist foreign policy orientation.

THE ROAD AHEAD

While the path ahead in Central Asia may seem treacherous, it is a known quantity with respect to business risks. As the Belt and Road Initiative starts taking more of a center stage in Chinese international policy formulation, China would need to consider building new paradigms of interaction with its Central Asian neighbors by building a security framework bilaterally or through the Shanghai Cooperation Organisation. While addressing the obvious threats to security such as terrorism, China may also need to ponder threats emanating from weak political institutions in these countries which are inherently unstable, their current authoritarian regimes notwithstanding. China would also need to look to fostering broader ties with the local communities in these countries to counter suspicion of collusion with the elite and also to better navigate change in regimes, if any. This poses unique challenges to China, which has scrupulously eschewed any export of ideology and its own peculiar institutional framework. Whether economic influence of the magnitude envisaged by the Silk Road Economic Belt can be divorced from political entanglements in Central Asia will be a formidable issue for Chinese policymakers to grapple with in the foreseeable future. ◆