

The Eurasian Economic Union and the Silk Road Economic Belt

Competition or Convergence? Implications for Central Asia

ANNA GUSSAROVA/FARKHOD AMINJONOV/YEVGENIY KHON

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- Although they have a very different design, the Eurasian Economic Union (EAEU) being an international organization with an administrative apparatus and the Silk Road Economic Belt (SREB) being more of an investment program, both initiatives aim to enhance economic relations within the Central Asian region..
- While Central Asia can benefit from infrastructure improvement and trade impulses of both initiatives, industrial and energy policy are poorly developed within the EAEU and SREB.
- Not only in the SREB, but also in the EAEU, the component of regional cooperation and integration for Central Asia is very weak or even completely missing.
- To be able to fully use the initiatives of the EAEU and the SREB to their advantage the Central Asian states need to foster the development of a regional cooperation mechanism.

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Introduction

The Eurasian Economic Union and the Silk Road Economic Belt are the most discussed initiatives to turn Central Asia from a 'land-locked' into 'land-linked' region. Multilateral formats of interaction are designed to set up regional interaction and cooperation frameworks. Territorial boundaries of the two initiatives overlap. And, they cover almost similar sectors of cooperative dynamics aimed at enhancing connectivity in the region.

Launched on January 1, 2015, the Eurasian Economic Union (EAEU) is the final stage of an economic integration process which started in 2000. In 1999 Belarus, Kazakhstan, Kyrgyzstan, Russia and Tajikistan signed an agreement on the Customs Union and Common Economic Space. The document determined three levels of integration: the Eurasian Economic Community (EurAsEC); the Common Economic Space and the Customs Union of Belarus, Kazakhstan and Russia (CU); and the EAEU. During the last stage of these processes parties were expecting to enjoy common markets with (a) harmonized legislation; (b) unified energy, transport, and communication infrastructure; (c) coordinated tax system; and, (d) free movement of goods, services, capital and labor force. Despite the fact that common markets, especially for strategically important goods, are still in the planning stage member states have succeeded to create an institutional apparatus which is capable of setting up a conceptual framework and integrating member states' markets.

Differently from the EAEU, the Silk Road Economic Belt (SREB), which was proposed in 2013 by the President of the People's Republic of China Xi Jinping, does not have a comprehensive institutional apparatus to enhance connectivity within the region. Nonetheless, the SREB also envisages cooperation in such areas as: coordination of national policy, development of infrastructure potential, liberalization and simplification of trade and investment, as well as financial and cultural cooperation. In fact, the SREB is perceived by the elites to be even more attractive to the Central Asian countries than the EAEU, because it does

not impose membership in the organization.

It is quite difficult to compare the EAEU and the SREB. The EAEU is an organization, while SREB is a program, the activity of which is based on bilateral agreements. In this regard, the two initiatives can to some extent complement each other. In addition, Russia is currently short of money to promote large-scale regional development projects, when China is penetrating almost all areas of interactions with its investments, credits and loans.

Currently, only two Central Asian countries are members of the EAEU, while the SREB initiative encompasses all five states. Russia and China have distinct interests over the region's energy resources, development of industrial production and trading goods. Most importantly, even though state leaders claim to improve interconnectivity among respective countries both within the EAEU and the SREB and establish certain mechanism governing relationships, evidence shows that the "regional" component within these initiatives is to a large extent missing.

So, the report aims to trace (a) the extent of complementarity of the two initiatives: the EAEU and the SREB; and (b) whether these initiatives represent well-functioning regional mechanisms in regulating such key areas of interaction as trading relations, infrastructure networks, industrial and energy sectors.

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1. Trade And Logistics Cooperation Between the EAEU and the SREB: The Role of Central Asia

1.1 Trade between the EAEU and China Creating Opportunities for Central Asia.

The EAEU member states recognize that it is advisable to foster China's initiative to cooperate. This project is strategically important for the EAEU both to determine and develop a common foreign trade policy of the Union and to form a legal framework for its cooperation with the largest trading partner – China.

Trade turnover between the EAEU and China has been quite unstable due to the economic stagnation in the EAEU member countries, particularly Russia and Kazakhstan. Since 2007, the export to China has grown from US\$ 26.9 bln to a maximum of US\$ 59.6 bln in 2012 (share of exports to China in the total exports of the EAEU increased from 6.3% to 8.9%). In 2016 it amounted to US\$ 32.9 bln (10.7%). Since 2007, import of goods to the EAEU from China increased from US\$ 39.9 bln to 72.9 bln in 2014 (the share of Chinese imports of the total imports of the EAEU rose from 15.0% to 19.1%). In 2016 it amounted to US\$ 45.7 bln (22.7%).¹ Hence, we can see that despite the decrease in monetary terms, China's share in the trade turnover continues to increase, establishing the PRC as a key trading partner.

At the same time, there is an asymmetry both in the relative weight of mutual trade and in the structure of mutual exports and imports. For instance, mineral raw materials, primarily fuel and energy, make up 73.3% of the EAEU exports. Meanwhile the main commodity groups of EAEU imports from China are machinery and equipment (29.1%), textiles (17.5%) and non-precious metals (10.2%).² In this regard, it is too early for the Central Asian parties to think about a Free Trade Agreement (FTA).

On May 8, 2015 in Moscow, Russia decided to start negotiations with China on concluding an agree-

ment on trade and economic cooperation, which served as a starting point in the issue of linking the projects of the EAEU and the SREB. The joint development of these projects has mutual benefits and wider opportunities for all participating countries, in areas such as promotion of bilateral trade, broader industrial cooperation, deepening of investment and financial cooperation. Priority is given to the development of common transport corridors. The EAEU member states believe that for Beijing their territory can become a faster alternative to existing sea routes for goods which are going to the EU. Additionally, due to the single customs territory of the EAEU, the markets of China and the European Union now share only one customs border, which is another distinct advantage of the trans-EAEU corridors.

So China is inevitably approaching Central Asia economically and the EAEU can be seen as an effective protection instrument of the national Central Asian markets while the preserve their investment attractiveness. Some experts believe that the SREB is just a more beautiful packaging of the concept of a "free trade zone in the SCO space" which was rejected by Russia and Central Asian countries. In this sense, its main essence is the creation of most favorable conditions to promote Chinese goods, services and capital in the region.³ Therefore it is easier for the EAEU members to have a unified position on China's proposal and protect their respective markets against the risk of being absorbed by China's cheap goods.

However, it is possible to consider cooperation within the framework of a non-preferential trade and economic agreement between China and the EAEU which envisages various forms of support for trade development and the implementation of specific investment projects. Such forms of support can include (a) assistance in finding partners and entering the market, (b) elimination of administrative barriers, (c) providing transparent conditions for investors to access the Chinese market, (d) protection of intellectual property rights, and (e) making payments in national currencies and so on.

¹ Statistical data taken from the Eurasian Economic Commission, <http://www.eurasiancommission.org/>.

² Statistical data taken from the Eurasian Economic Commission.

³ "Transportnie Koridory Na Evraziyskom Prostranstve: Ekonomika I Geopolitika (Transport Corridors in the Eurasian Space: Economy or Geopolitics)," KISI, <http://kisi.kz/uploads/33/files/KuXXVFLd.pdf>.

Another advantage of the EAEU is the formation of general rules for economic activities with no customs barrier between its participants. As a result, the EAEU market becomes economically attractive for Chinese business. For instance, establishing ventures in Kazakhstan and Kyrgyzstan will allow Chinese companies to easily export its goods to the common markets of other member countries. It is also expected that the attraction of Chinese investment to infrastructure and industrial projects in EAEU countries will give a new impetus to their development. Therefore, it is also important for the Central Asian states to participate in the implementation of integration projects, thereby effectively using emerging opportunities and advantages of regional cooperation, while at the same time minimizing risks and threats. This can become an additional catalyst to create new clusters of economy and, ultimately, lead to the growth of other sectors, including industry.

Over the past decade, Russia has weakened its economic position in Central Asia. This is due to the reduction of trade ties with the countries of the region, the deterioration in the quality of exports and resources. Nevertheless, Moscow has retained serious economic levers of influence, which may be the following: (a) the largest regional migration still flows on its territory and significant remittances of labor migrants for the national budgets; (b) preferential supplies of energy resources and military equipment;⁴ (c) supplying countries of the region with final products; and (d) creation of a common economic space with Kazakhstan and Kyrgyzstan. So, China could be regarded as an economic competitor of the Russian Federation in the region. But one also has to bear in mind that Beijing is ready to have this competition in a civilized and non-confrontational way.

For the entire Central Asian region, such large-scale projects potentially mean diversifying the sources of public revenues, creating additional jobs and improving the overall economic situation. In

the long term, the development of cooperation will strengthen the complementarity of the economies of the countries participating in the SREB and can naturally lead to the removal of these trade barriers, once Central Asian countries and Russia are confident enough in their producing capacities. As a result, a huge free trade zone in the Eurasian continent can be formed where Central Asia becomes the main link. However, economic and trade cooperation is highly dependent on the availability of effective transport infrastructure, which is why this topic has become a cornerstone of the SREB initiative in Central Asia.

1.2 China's Trade Expansion to Non-EAEU Central Asia.

The growth of mutual trade has been a natural consequence of China's economic policy in Central Asia, not only in EAEU member states. There is an unambiguous upward trend in mutual trade which we see in the first decade of the 21st century. Exports of Chinese goods (mainly consumer goods and equipment) are increasing as well as China's imports from Central Asia.⁵

For Russia as a key player in the region, this trend is controversial and harbors both opportunities and risks. For instance, the entry of China into the Turkmen gas market has reoriented it to the eastern direction, making it unlikely that Turkmen gas appears in European pipelines, where it would compete with Russian raw materials. On the other hand, considering products with higher added value, cheap Chinese consumer goods are gradually replacing Russian products in Central Asia.

For the potential members of the EAEU, Uzbekistan and Tajikistan, trade promotion with China also became a top priority under the SREB. For instance, in mid-June 2015, Uzbekistan and China signed a Protocol on the expansion of mutually beneficial trade and economic cooperation within the framework of the construction of the „Silk Road Economic Belt“.⁶ The protocol provides that

4 "Rossiya Postavila Kirgizstanu Partiyu Voennoy Texniki I Vooruzheniya (Russia Supplied Kyrgyzstan Military Equipment and Weaponry)," <http://kyrtag.kg/society/rossiya-postavila-kyrgyzstanu-novuyu-par-tiyu-voennoy-tekhniki-i-vooruzheniya/>; "Zachem Rossii Postavlyat v Tadjikistan Voennuyu Texniku I Orujie (Why Would Russia Supply Tajikistan Weaponry and Military Equipments)," http://www.caobzor.com/2016/12/blog-post_50.html.

5 "Ekonomicheskaya Strategiya Kitaya v Tsentralnoy Azii: Zadachi, Instrumenti, Rezultati (Economic Strategy of China in Central Asia: Goals, Instruments, Results)," *R/SS*, <https://riss.ru/analitics/28788/>.

6 "Uzbekistan I Kitay Podpisal Protokol o Sotrudnichestve (Uzbekis-

Uzbekistan and China, within the framework of the joint construction of the SREB, will fully apply the current mechanism of bilateral trade and economic cooperation and deepen and expand mutually beneficial cooperation in trade, investment, financial, transport and other spheres.

The development of infrastructure, which is generously supported by China's investments, will also lead to the growth of Chinese exports to the region. This is particularly evident in the case of Tajikistan where, after the opening of the border which crosses the Kulma Pass, the volume of Chinese exports to the republic increased several times.⁷ In the long term, such a trend can be expected in Uzbekistan, too, which is the third most important market for China in the Central Asian region. Uzbekistan's role will inevitably grow after the completion of a number of infrastructure projects and the opening of a railway connection through Kyrgyzstan.

Tajikistan also aims to receive substantial investments and intensify trade relations with China. Some concerns are raised whether the accession to the EAEU can negatively affect the level of economic assistance from Beijing. On the other hand, China recognizes Russia's special role as key trading partner, investor and destination for Tajik migrants and it is unlikely that a direct confrontation with Moscow takes place. Also, considering the effort which is put in connecting the EAEU with the SREB it might be an additional stimulus for Tajikistan to join the EAEU.

1.3 Transit Ambitions of the Central Asian Countries and the Battle for China's Freight

Since 2013, when the SREB initiative was introduced, the development of transport corridors has become a major priority for all land-locked Central Asian states. Being placed between the huge markets of the EU and China each country positions itself as key transit hub for all goods moving in the

East-West direction. Lacking funds Central Asian republics attract China's investment not only by creating favorable conditions for investors, but also by designing government development programs which could be connected with the SREB.

For instance, **Kazakhstan** has a specific state infrastructure development program called "Nurly Zhol" which in 2014, during Nazarbayev's visit to Beijing, was connected with China's SREB. Astana believes that the development of the necessary transportation capacities will not only allow expanding bilateral trade volumes, but also provide opportunities to increase the transit of Chinese cargo into the EAEU and European countries. According to experts' estimates, by 2020 the cargo turnover on the Khorgos Gate which connects China and Kazakhstan through railway, road and oil pipeline will have reached 20 million tons per year, and by 2030 – up to 35 million tons.⁸

The importance of the transport-transit component in the economic relations between Kazakhstan and China is continuously increasing due to Astana's interest in developing infrastructure as a part of countercyclical economic measures and its desire to become a major Eurasian logistics hub. For Beijing, whose main consumer of goods is the EU, transit through Kazakhstan can become a reliable alternative to other routes and the opportunity to strengthen connectivity with the Central Asian region which will further stimulate the development of the western Chinese provinces.

Kazakhstan also needs to strengthen the integration of its own transport infrastructure into the global network which not only will facilitate the export of domestic products to world markets in the future, but also present an additional source of income for the public and private sectors which are involved in logistics. The top priorities are rail and road transit corridors, because the share of both types in transit is 90–95%.⁹

With regard to road transport, the main project for Kazakhstan is the participation in the trans-

tan and China Signed an Agreement on Cooperation), "Gazeta.uz, June 17, 2015, <https://www.gazeta.uz/ru/2015/06/17/protocol/>.

7 "Rost Kitayskogo Prisutstviya v Tadjikistane (Increasing Chinese Presence in Tajikistan)," http://www.perspektivy.info/history/rost_kitajskogo_prisutstviya_v_tadzhikistane_2014-05-21.htm.

8 "China opens second railway to Kazakhstan," *Xinhuanet.com*, December 22, 2012, http://news.xinhuanet.com/english/china/2012-12/22/c_132057373.htm.

9 Data from the Committee on statistics of the RK, stat.gov.kz.

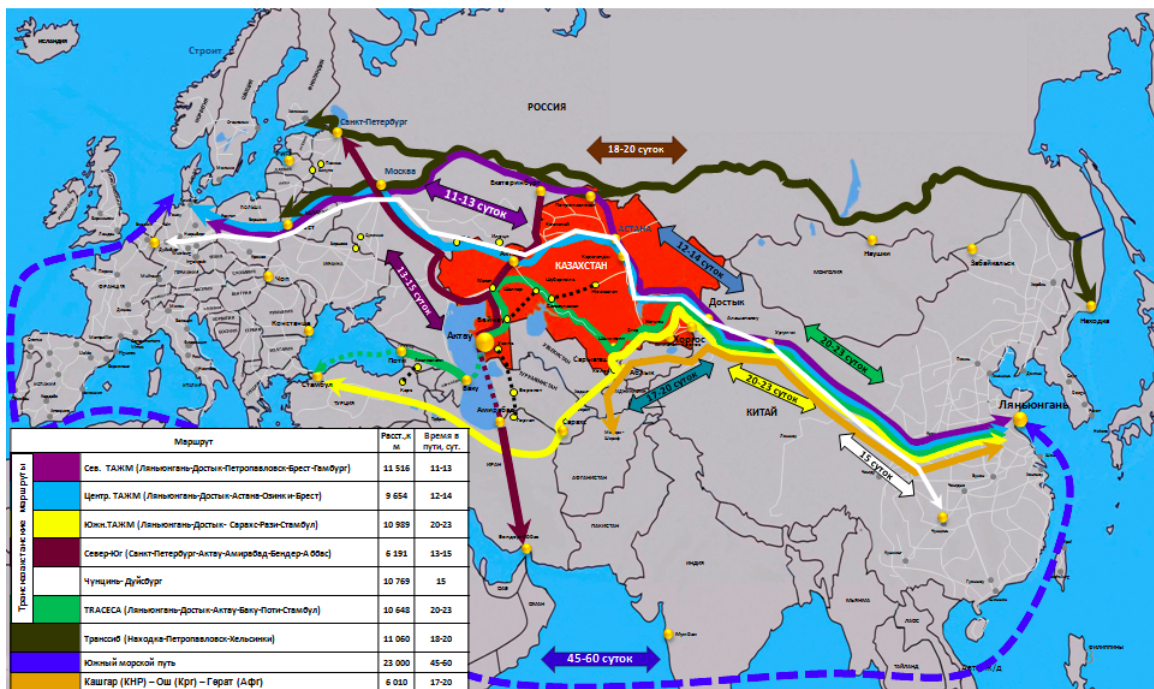
continental corridor „Western Europe – Western China“. The total length of the corridor is 8,445 km. In Kazakhstan it passes through five regions – Aktobe, Kyzylorda, South-Kazakhstan, Zhambyl and Almaty. Most of the Kazakhstani section has already been reconstructed and opened in the end of 2016.

The opening of this transport artery has significant benefits for both Kazakhstan and neighboring countries. The highway „Western Europe – Western China“ will significantly reduce the time of cargo transportation in comparison with the existing alternative corridors. The route from the Chinese port of Lianyungang to the EU will take about 10 days. According to experts this optimization will increase cargo transportation 2.5 times by 2020 and the average annual total economic effect will amount to 33.9 bln tenge.¹⁰

Kazakhstan also takes a leading role in the development of railway infrastructure. Since the beginning of independence Kazakhstan built more railways than all CIS countries combined.¹¹

By developing railways Astana wants to compete with the existing Trans-Siberian and South Sea route. Both of these routes are less favorable to China in terms of length and time than the route through Kazakhstan (from the Chinese city of Chongqing through the Kazakh Dostyk station on the border with China to the German city Duisburg which is located in the delta of the rivers Rhine and Ruhr in North Rhine-Westphalia) (Fig. 1). According to the „JSC National Company Kazakhstan Temir Joly“ the distance of the Trans-Siberian route is 11,100 km and transit time is 18–20 days, the Southern Sea Route is 23,000 km and 45–60 days, Kazakhstan's route is 10,800 km and 15 days.¹²

Figure 1: **Kazakhstan in the system of international transit corridors**



Source: JSC «NC «KTZH»

10 "Znachenie Proekta "Zapadnaya Evropa-Zapadnyy Kitay" v Razvii Regiona Kazaxstana (Importance of the "West Europe-West Kazakhstan Project in the Development of Regions of Kazakhstan)", <http://www.europe-china.kz/info/86>.

11 "Dorogi Nezavisimosti: 2.5 Tisyach Kilometrov za 25 Let (Roads of Independence: 2.5 thousand Kilometers in 25 Years)", <http://su0.ru/O10w>.

12 "Kazakhstan broadens the geography of transport-logistics strategy," *Official cite of the Prime Minister of the RK*, <http://www.primeminister.kz/news/show/21/kazakhstan-rasshirjaet-geografiju-transportno-logisticheskoy-strategii/26-12-2012>.

The implementation of the above-mentioned infrastructure projects is a part of the strategic initiative „Kazakhstan – New Silk Road“ which was announced in 2012 by the President Nazarbayev. In accordance with this initiative the President wishes to see Kazakhstan to become the largest business and transit hub of the Central Asian region, through which will pass most of the cargo between Europe and Asia.

Likewise **Kyrgyzstan** under the Silk Road Economic Belt Initiative tries to utilize its transit potential and attract China's investment into its own transport infrastructure projects. In terms of Kyrgyz-Chinese cooperation lots of debates are related to the China-Kyrgyzstan-Uzbekistan railway line which is being discussed since the beginning of the 2000s. Kyrgyzstan believes that the line could lead to direct revenues from transit activities and open access to new markets, including to Iran. According to a feasibility study the new railway will connect with the existing railroad crossing in Naryn and Jalal-Abad oblasts and leave Kyrgyzstan for Uzbekistan. The total length of the railway is estimated at 433 kilometers. The project requires US\$ 5 bln and the construction is planned to be 8 years.¹³ It is expected that 12 million tons of cargo will be transported through the territory of Kyrgyzstan per year.¹⁴

On the other hand, some experts question the potential benefits of building and operating the railroad. They emphasize that real income from transit, previously estimated at US\$ 200 mln, can actually be lower and the project will not even pay off.¹⁵ This is especially important considering that the Chinese share in Kyrgyzstan's foreign debt amounts to 38.4%. The total debt of the country equals 56.3% of the country's GDP.¹⁶ Another point mentioned by the critics is that the route through Kyrgyzstan will not be competitive with the one going through Kazakhstan's territory. Among the

reasons is the necessity to cross four borders including with Uzbekistan which has complex procedures when it comes to customs, compared to three borders via the route through Kazakhstan.¹⁷

The participating countries have discussed the issue of implementing such a large project for many years. However, parties have not yet reached a single agreement. Despite the fact that the implementation of this idea has already politically matured, there remain questions of economic and technical nature, but most importantly, the financing has not yet been determined. Thus, plans to modernize the transport infrastructure of Kyrgyzstan extremely depend on the availability of foreign investment.

Tajikistan has only one railway line – through Uzbekistan – which connects the country with the post-Soviet space. However, due to the complexities of relations between Tashkent and Dushanbe, this route has been closed on Uzbek territory since 2011. Dushanbe has repeatedly stated the need to build new railways, but has not yet managed to find investors to implement its plans. Despite the fact that for economic reasons Beijing refrains from lending money to build a railway line to Iran through Tajikistan, it actively participates in other transport projects in Tajikistan.

China is now considered the main investor in Tajikistan's economy. Dushanbe's debts to Beijing exceeded US\$ 1 bln which is a half of Tajikistan's foreign debts.¹⁸ In recent years China has repeatedly provided Tajikistan with concessional loans. These debts were mainly spent on infrastructure, in particular on the construction of roads and tunnels. The priority of Chinese construction projects in the transport sector is the development of the Dushanbe-Kulma-Kashgar automobile corridor which should connect the main Tajik cities with the road system of northwestern China.¹⁹

13 "Jeleznaya Doroga iz Kitaya: Poka Tolko Na Bumage (Railroad from China: So Far Only on Paper)," <https://rus.azattyk.org/a/28250725.html>.
14 *ibid*.

15 "Jeleznaya Doroga Kitay–Kirsizstan–Uzbekistan: Voprosi Bez Otvetov (Railroad China–Kyrgyzstan–Uzbekistan: Questions Without Answers)" VB.kg, http://www.vb.kg/doc/214902_jeleznaiia_doroga_kitay_kyrgyzstan_uzbekistan_voprosy_bez_otvetov.html.

16 "Dolgi Kirgizstana: Vse Dorogi Vedut v Kitay (Kyrgyzstan's Debts: All Roads Lead to China)," 24.kg, https://24.kg/ekonomika/40710-dolgi_kyrgyzstana_vse_dorogi_vedut_v_kitay/.

17 "Kirstan na Peretu'e: Rossiya i Kitay delyat Jeleznuyu Dorogu (Kyrgyzstan on the Crossroad: Russia and China is Dividing Railroad)" Zanoza.kg, http://zanoza.kg/doc/336995_kyrgyzstan_na_perepyte_rossiia_i_kitay_deliat_jeleznuyu_dorogu.html.

18 "Kitay Obeshaet \$500 Millionov i Nachala Stroitelstvo Obogotitel'nogo Kombinata (China Promises \$500 Million and Start of the Factory Building)," <https://rus.ozodi.org/a/27797314.html>.

19 "Rost Kitayskogo Prisutstviya v Tadjikistane (Increasing Chinese Presence in Tajikistan)," http://www.perspektivy.info/history/rost_kitayskogo_prisutstviya_v_tadjikistane_2014-05-21.htm.

China heavily invests in transport projects in **Uzbekistan** as well. Last year the construction of an electrified railway which links the Fergana Valley with the main part of Uzbekistan was completed. Previously, the railroad from Tashkent to the Fergana Valley went through the territory of Tajikistan. The new road will exclusively pass Uzbek territory.²⁰

Uzbek authorities prefer to diversify sources of investment in order to reduce dependence on China's loans. The total cost of the Angren-Pap railway project was estimated at US\$ 1.68 bln of which over US\$ 1.08 bln is invested by Uzbekistan Temir Yollari, the Fund for Reconstruction and Development of Uzbekistan and the state budget. About US\$ 450 mln were provided by the Chinese „Eximbank“ and US\$ 195 mln by the World Bank.²¹

The new route may be used to include Uzbekistan into the global logistics network of China, if Beijing builds the China-Kyrgyzstan-Uzbekistan railway. If the project is implemented, the route through Uzbekistan will connect the Xinjiang Uyghur Autonomous Region with the countries of the Persian Gulf.

Unlike the rest of the Central Asian states, **Turkmenistan** does not prioritize in its agenda to become a “key transit point” in the region, even if that means to be less involved in China's SREB and investments in infrastructure (this excludes pipelines). In terms of Turkmenistan's participation as a transit hub the China-Kazakhstan-Turkmenistan-Iran corridor is the main project. On January 28, 2016, the container train from Yiwu city in China to Tehran successfully crossed Kazakhstan and Turkmenistan. The trip took just 16 days which is twice as fast as the sea routes.²² This became possible with the Uzen-Bereket-Gorgan railway line which was opened in 2014.

20 “Jeleznaya Doroga Angren–Pap: Chego Jdat' Kyrgyzii I Tadjikistanu (Angren–Pap Railroad: What to Expect by Kyrgyzstan and Tajikistan)?” <https://regnum.ru/news/polit/2091030.html>

21 Ruslan Izimov, “Rol i Mesto Uzbekistana v Tsentralnoaziatskoy Politiki Kitaya (The Role and Place of Uzbekistan in Central Asian Policy of China),” Cabar.asia, <http://cabar.asia/ru/rol-i-mesto-uzbekistana-v-tsentralnoaziatskoj-politike-kitaya/>.

22 “Jeleznuyu Dorogu “Kitay–Kazaxstana–Turkmenistan–Iran” Prezentovali v Pekine (Railroad “China–Kazakhstan–Turkmenistan–Iran” Was Presented in Beijing),” https://forbes.kz/news/2016/04/26/news-id_110648.

However, the Kazakhstan-Turkmenistan-Iran corridor plays a strategic role for the EAEU as well. The North-South corridor offers Kazakhstan and Turkmenistan transit opportunities for trade with Russia, Belarus as well as Eastern Europe and the Middle East. The North-South corridor plays a crucial role for Russia and Kazakhstan in the oil cooperation with Iran. It is expected that the trans Kazakhstan railway route will give an incentive to the „oil exchange“ operations which were carried out between Iran, on one hand, and Russia, Kazakhstan and Turkmenistan, on the other. The Iranian government under Ahmadinejad suspended these operations in August 2010, as the partners did not agree to raise fees from US\$ 1.1 per barrel to US\$ 5.5. Because of this decision, Iran lost up to US\$ 200 mln a year in terms of overall economic gains, which is why the government under Rouhani tries to resume the negotiations.²³

The resumption of swap operations between Russia, Kazakhstan and Iran may benefit all parties. While Kazakhstan and Russia will be able to diversify their export routes, Iran will optimize its oil refinery process, because most of its oil fields are located in the south. When swap operations resume, Iran will have the opportunity to receive Caspian oil in the north for further refinement in its factories. Russia and Kazakhstan, in turn, will receive the corresponding volumes of Iranian oil at the Persian Gulf.

1.4 Common Challenges and Obstacles in the Central Asian Transit Development

Even though it is actively worked to develop the infrastructure, transit remains only a small fraction of the total cargo. For instance, in Kazakhstan, which is the most advanced economy in Central Asia, transit is only 5% of the total cargo. One of the reasons for this is the low efficiency of cargo flow organization.

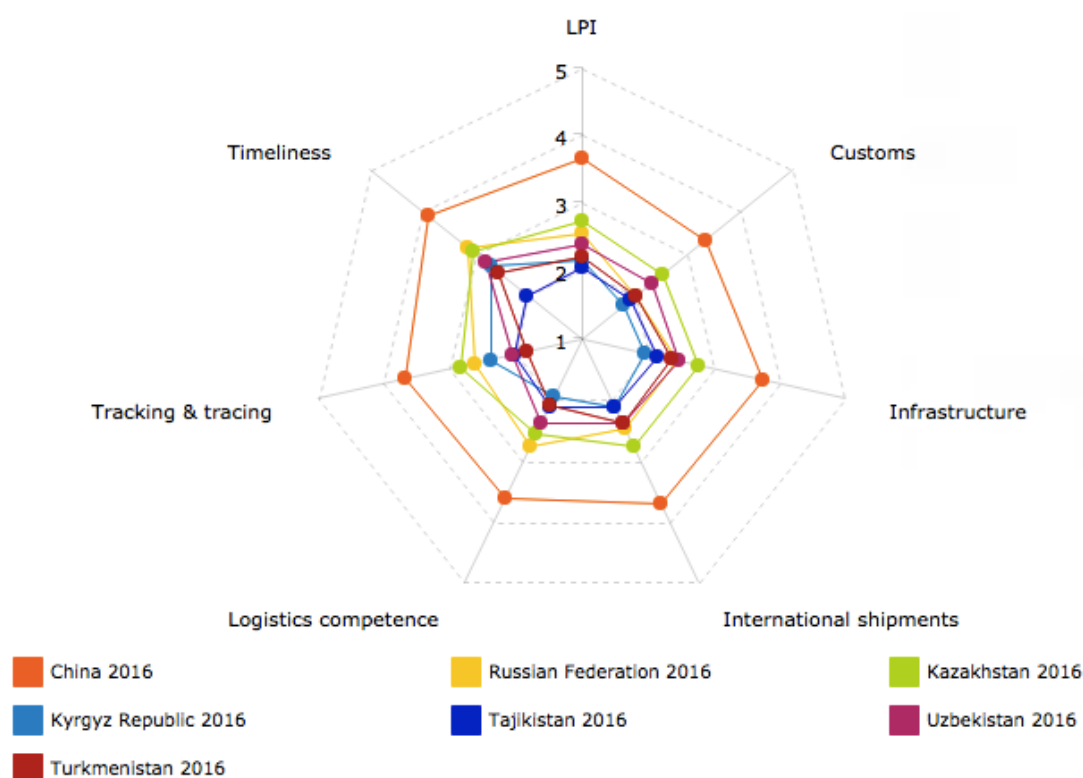
According to the Logistics Performance Index 2016, calculated by the World Bank, Kazakhstan ranked 77th out of 155 countries. Comparative

23 “Iran and Central Asia: Vozmojen li Noviy Transportniy Proriv (Iran and Central Asia: Is Transportation Boom Possible)?” <http://www.iran.ru/news/economics/94412/>.

analysis of the six criteria of the index showed that Kazakhstan significantly lags behind China which ranked 27th in 2016 (Fig. 2). The rest of the Central Asian countries are ranked even further behind when it comes to logistics performance. Uzbekistan is closest to Kazakhstan and Tajikistan least developed in this area.

The issue of transport infrastructure depreciation also applies to highways. According to the Ministry of Transport and Communications of the Republic of Kazakhstan, the share of good quality roads in Kazakhstan is 17%, satisfactory roads 49%, unsatisfactory 34%.²⁶ Poor road quality is one of the reasons for the high fuel consumption,

Figure 2: **Logistics Performance Index 2016**



Source: World Bank

The level of physical depreciation of infrastructure is extremely high in all Central Asian countries. For instance, In Kazakhstan this indicator lies at 60% in the railway sector, while the standard should not exceed 40%.²⁴ In Kyrgyzstan, the degree of depreciation of the most critical sections of the railway is 71%.²⁵

frequent road accidents and a low speed for the delivery of goods. All of this significantly affects both the delivery time and the cost of using the transit corridors of Central Asia.

In the analysis of transit corridors, one should also take into account growing competition for China's transit. All countries to some extent hope to become a major logistics hub and a key player in transit operations between China and the EU.

²⁴ "Transportnaya Strategiya RK do 2015 goda (Kazakhstan's Transport Strategy Until 2015)," *Republic of Kazakhstan*, http://ru.government.kz/docs/u060086_20060411~1.htm.

²⁵ "Razvitie Torgovli v Regione CAREC: Potencial Zheleznix Dorog Centralnoj Azii (Development of Trade in CAREC Region: Railroad Potential of Central Asia)," <http://mirperemen.net/2017/05/razvitie-torgovli-v-regione-cares-potencial-zheleznix-dorog-centralnoj-azii/>.

²⁶ "O Strategicheskimi Plane Ministerstva Transporta i Kommunikacii RK na 2014–2018 (About Strategic Planning of the Ministry of Transport and Communication of the RK for 2014–2018)," *Kazpravda.kz*, http://kazpravda.softdeco.net/_pdf/feb14/180214decision.pdf.

Not only Central Asia, but Russia as well increases the capacity of its own corridors, including the Trans-Siberian railway, to attract a bigger amount of Chinese goods going west. Russian analysts claim that the Trans-Siberian is the easiest route for the SREB, arguing that the Central Asian routes are unprofitable and lacking prospects.²⁷

Despite the fact that government officials remain quite positive in regards to China's active engagement in the region both with the EAEU and non-EAEU members, certain risks are being raised in the expert community. Among those risks is the lack of information on the project's conditions. Experts believe that infrastructure projects can stir corruption with government institutions which are ineffective in combating corruptive practices. Growing dependence on China is among other risks for the region. Limited financial resources for the maintenance, operation and development of the infrastructure in recent years have led to significant degradation of the infrastructure. Budgetary constraints do not allow increasing public investments into modernization of facilities and implementation of new projects. To date, the rehabilitation of existing road networks and the construction of new ones are implemented through loans which are significantly backed by China. In the long term economic dependence could become a political one, especially for countries which do not possess vast amounts of natural resources. This factor can be a motivation for them to join the EAEU as a protective union against China's expansion.

27 "Transib–Naibolee Realistichniy Variant EPSHP (Transib–The Most Realistic Option for SREB)," <http://russiancouncil.ru/analytics-and-comments/analytics/transsib-naibolee-realistichnyy-variant-epshep/>.

2. The EAEU vs. The SREB Industrial Policies: Priorities, Challenges and Opportunities for Central Asia

Balancing between Russia-led EAEU and China-led SREB initiatives, Central Asian states should clearly show their interests and capabilities. As it is of high importance to enhance and boost regional interaction, countries prefer Chinese rapid investment as well as incomprehensible and obscure return conditions over short-term politically motivated Russian ambitions and regime stability. As the common industrial market has been challenged even since the Customs Union and Common Economic Space, Central Asian states continue to maintain protective mechanisms to support domestic industries, rather than open their borders towards integration.

2.1 The EAEU Nationalized Industrial Agenda

According to the Treaty on the EAEU, “the objectives of industrial policy are to (a) accelerate the sustainability of industrial development, (b) increase the competitiveness of member states’ industrial complexes, (c) implement effective cooperation for innovation, and (d) remove barriers in industrial sector, including the movement of industrial goods”.²⁸

Governments also agreed to provide opportunities to use advanced financial products (leasing, pre-export and export financing of jointly produced products), priority use of international and regional technical standards, and implementation of quality management systems (QMS). Industrial policy calls for a deepening of cooperation between many small and medium-sized enterprises (SME), creating new production chains, and providing opportunities for a common mutually beneficial marketing strategy in the markets of third countries (instead of unreasonable competition).²⁹

28 Treaty on the Eurasian Economic Union, http://www.un.org/en/ga/sixth/70/docs/treaty_on_eeu.pdf.

29 Промышленная политика ЕАЭС: от создания к первым результатам (Industrial Policy of the EAEU: From the Creation to the First Results), ed. S.S. Sidorskogo, Moscow, 2015, 37, <http://www.eurasiancommission.org/ru/Documents/промышленность%20русск%20small.pdf>.

However, Art.92 “Industrial Policy and Cooperation”³⁰ and Annex 27 to the EAEU Treaty casts light upon the absence of the EAEU common industrial policy. It is very significant that member states themselves prioritize and determine corresponding directions of their industrial policies, not the EAEU agencies. In many respects, the logic and experience of the European Union did not work in the EAEU member states’ approach to integration.

Starting from 2013 to 2014 Belarus has been constantly trying to implement five joint “pilot” industrial projects with Russia. Among them were the merger of JSC “MAZ” and JSC “KamAZ” into “Rosbelavto”, JSC “Integral” and JSC “Russian Electronics”, JSC “Minsk Wheel Tractor Plant” and JSC “Rostekhnologii”, JSC “Peleng” and “Roskosmos”, JSC “Grodno Azot” and “EuroChem”, Mineral and Chemical company.³¹ In addition, Minsk has been pushing coordination mechanisms within the Union State of Russia and Belarus, then within the Customs Union and the EAEU industrial policy. In 2016 the Deputy Chairman of the Belarus Council of Ministers Vladimir Semash³² noticed: “Despite all agreements and arrangements within the EAEU, its member states are seeking to protect their respective markets as there is discrimination of Belarusian suppliers. As not all contradictions have been eliminated, Belarus keeps bargaining with the Russian counterparts. And since then, no improvement has been achieved in terms of establishing integrated industrial projects. Evidently, failure to agree on a “pilot” project raises the question about the ability even to discuss these issues under the EAEU in the mid-term perspective.

Despite quite a developed organizational structure (Fig. 3), the presidents of the EAEU member states primarily take strategic decisions according to their respective countries’ development goals. And the agenda is significantly politicized. Moreo-

30 Treaty on the Eurasian Economic Union Section XXIV, art. 92. Astana, May 29, 2014.

31 “Pravitelstvo Belarussii: Edinaya Promyshlennaya Politika EAES Nujna (Government of Belarus: Common Industrial Policy of the EAEU Is Needed),” *Regnum.ru*, <https://regnum.ru/news/economy/2127806.html>.

32 “Semashko Schitaet Nedostatochnoy Rabotu po Formirovaniyu Edinoj Promyshlennoy Politiki v EAES (Semashko Believes that the Work on the Formation of the Common Industrial Policy of the EAEU Is Insufficient),” <http://www.belta.by/economics/view/semashko-schitaet-nedostatochnoj-rabotu-po-formirovaniyu-edinoj-promyshlennoj-politiki-v-eaes-192032-2016/>.

ver, Armenia and Kazakhstan do not have a Ministry of Industry. Most importantly, in 2014 to 2015 Kazakhstan government agencies did not provide any project on light industry within the EAEU Plan, while the potential seems to be quite promising (there are 1.151 enterprises in general, but only five among them were ready to cooperate within the EAEU).³³ In this case, Kazakhstan entirely relies on its "Nurly Zhol" National Program, which has been integrated into the China-led SREB initiative.

Currently, the EAEU member states are trying to coordinate national strategies to combine their production, research, intellectual and material capacities and enhance their competitiveness.³⁴ It turns out that national development and even multilateral cooperation are perceived as an EAEU industrial agenda, which in fact is not true. Especially, there is confusion in the media where they report on bilateral industry projects and present them as EAEU achievements.

Figure 3: **EAEU decision making process, industry.**

The Board of Eurasian Economic Commission				
Board Member (Minister), Industry and Agroindustry				
Secretariat				
Department of Industrial Policy				
Department of industrial policy, interstate programs and projects				
Department for Cooperation on Industrial Policy				
Department of industrial subsidies				
Department for monitoring and analysis (Common Economic Space industrial complexes)				
ADVISORY BODIES				
Advisory committee on industry				
Working Groups				
Basic directions of deepening industrial cooperation among Belarus, Russia and Kazakhstan, coordination of national policies with the prospect of carrying on a coherent industrial policy				
Proposals for cooperation and industrial technological platforms in Common Economic Space				
Modalities for new and existing car assembly plants in Customs Union and Common Economic Space				
Procedures for development and implementation of interstate programs, including financial mechanisms				
Expert Groups				
Industrial production for rail transport				
Industrial cooperation in aviation and space industry				
Machine tool development				
Production of building materials				
Pharmaceutical industry				
Nano industry				
Handling equipment				
Chemical and petrochemical industry				
Industrial cooperation in the field of ferrous metallurgy				
Light industry				
Agricultural machinery				
National Agencies				
Armenia	Belarus	Kazakhstan	Kyrgyzstan	Russia
- Ministry of Economy;	- Ministry of Economy;	- Ministry of Investment and Development;	- Ministry of Energy and Industry;	- Ministry of Industry and Trade;
- Industrialists and Entrepreneurs Union	- Ministry of Industry;	- Ministry of National Economy;	- Ministry of Economy;	- Ministry of Economic Development;
	- BelAPP Republican association of industrial enterprises	- Atameken National Chamber of Entrepreneurs	- Industrialists and Entrepreneurs Union	- Industrialists and Entrepreneurs Union

Source: Промышленная политика ЕАЭС: от создания к первым результатам (Industrial Policy of the EAEU: From the Creation to the First Results), ed. S.S. Sidorskiy, Moscow, 2015, 107.

³³ Промышленная политика ЕАЭС: от создания к первым результатам (Industrial Policy of the EAEU: From the Creation to the First Results), ed. S.S. Sidorskiy, Moscow, 2015, 71.

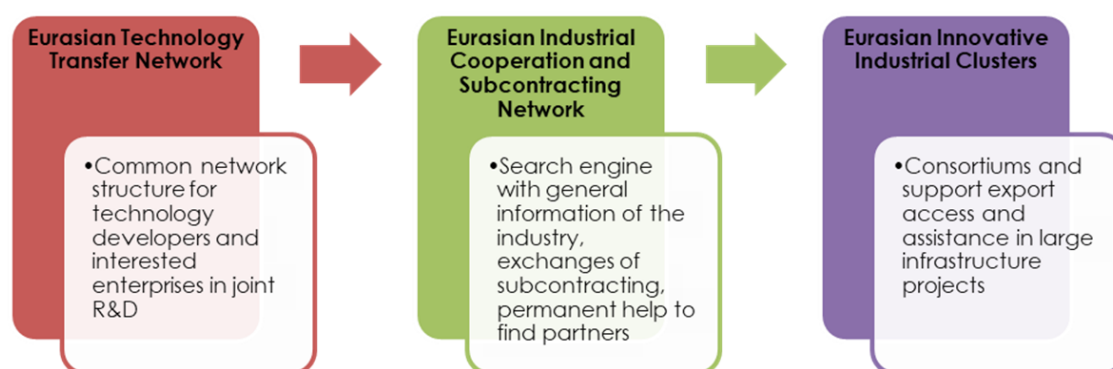
³⁴ Промышленная политика ЕАЭС: от создания к первым результатам (Industrial Policy of the EAEU: From the Creation to the First Results), ed. S.S. Sidorskiy, Moscow, 2015, 27.

As for research, technical and innovative cooperation, the EAEU member states agreed to develop and establish the Eurasian Technology Transfer

Network (until July 2017), the Eurasian Industrial Cooperation and Subcontracting Network, the Eurasian Innovative Industrial Clusters, interstate programs and projects (implementation plan to be finished until December 31, 2017), business innovation infrastructure, and interaction with international organizations, including United Nations Industrial Development Organization (UNIDO).³⁵

Even though the statistics do not reflect the peculiarities of the EAEU industrial policy, it does demonstrate national development priorities. In terms of share, Russia got 88.4% of the industrial production in the EAEU, Kazakhstan 6.3%, Belarus 4.6%, Armenia 0.4% and Kyrgyzstan 0.3%. While manufacturing industry make up the largest share in industrial production (66.1%), the former very significant mining declined (23.7%) and so did the production and distribution of electricity, gas and water (10.2%).³⁸ Belarus shows with 86.6% the largest share of manufacturing industry. In Kyrgyz-

Figure 4: **EAEU Instruments for cooperation in research, technical and innovation cooperation.**



Source: "Osnovnye Napravleniya Promishlennogo Sotrudnichestva v Ramkax Evraziyskogo Ekonomicheskogo Soyuza (Main Directions of the Industrial Cooperation Within the Eurasian Economic Union)," http://www.eurasiancommission.org/ru/act/prom_i_agroprom/SiteAssets/брошюра%20пусч%20OK%20NEW.pdf.

Common industrial policy should also provide joint innovation infrastructure, including the Eurasian network of technology transfer, technology platforms, clusters, and engineering centers. In this regard, digital transformation of the member states' industries will facilitate the transition to a digital economy.³⁶ Considering the launch and implementation of joint and national projects and initiatives, the share of digital economy in the EAEU'sGDP could reach 30%.³⁷

³⁵ Промышленная политика ЕАЭС: от создания к первым результатам (Industrial Policy of the EAEU: From the Creation to the First Results), ed. S.S. Sidorskogo, Moscow, 2015, 41.

³⁶ Промышленная политика ЕАЭС: от создания к первым результатам (Industrial Policy of the EAEU: From the Creation to the First Results), ed. S.S. Sidorskogo, Moscow, 2015, 38.

³⁷ "V EAES Dolya Tsifrovoy Ekonomiki v VVP Stran Soyuzha Mojet Sostavit ne Menee 30% (The Share of the Digital Economy in the GDP of the EAEU May Account for 30%)," <http://profit.kz/news/38283/V->

stan, the manufacturing industry generates 78.2% of industrial production, in Russia 66.8%, in Armenia 61.9% and in Kazakhstan 41.5%. In 2016, Russia continued to increase its volume of industrial production, and a steady increase was registered in Armenia. In Kyrgyzstan there was a transition from a recession to an increase in volumes, in Belarus and Kazakhstan the decrease in volumes slowed down.³⁹

EAES-dolya-cifrovoy-ekonomiki-v-VVP-stran-Souza-mozhet-sostavit-nemenee-30/.

³⁸ Промышленная политика ЕАЭС: от создания к первым результатам (Industrial Policy of the EAEU: From the Creation to the First Results), ed. S.S. Sidorskogo, Moscow, 2015, 3.

³⁹ "Promishlennost Gosudarstv-chlenov Evraziyskogo Ekonomicheskogo Soyuza za Yanvar-Dekabr 2016 (Industrial Production of the EAEU for January-December 2016)," http://www.eurasiancommission.org/ru/act/prom_i_agroprom/dep_prom/SiteAssets/Материалы%20в%20разделе%20Аналитика/Обзор%20202016%20год.pdf.

Figure 4: EAEU industrial development priorities

Country	Strategic industries and national priorities
Armenia	Mining and non-ferrous metallurgy, food industry, pharmaceuticals, textiles and jewelry industry
Belarus	Microelectronics, photonics, pharmaceuticals, high-precision machinery; wood processing, pulp and paper production, food production, other non-metallic mineral products, flax products, leather and footwear, and chemical production
Kazakhstan	Ferrous metallurgy, non-ferrous metallurgy, oil refining, oil and gas chemistry, food production, chemicals for industry, building materials, production of motor vehicles, parts, accessories and engines, electrical machines and equipment, agricultural and railway machinery, machinery and equipment for the mining industry, oil refining and oil-extracting industry
Kyrgyzstan	Mining industry, hydropower, tourism, and agriculture
Russia	Defense and security, economic development and transition, welfare and employment

Source: "Osnovnie Napravleniya Promishlennogo Sotrudnichestva v Ramkax Evraziyskogo Ekonomicheskogo Soyuza 2014-2015 (Main Directions of the Industrial Cooperation Within the Eurasian Economic Union 2014-2015)," 28-41.

2.2 EAEU Priorities and Challenges

The EAEU areas⁴⁰ of industrial cooperation until 2020 include:

- (a) New competitive industrial products for the total Union market saturation and exports to the third countries (import substitution);
- (b) Innovative development of the EAEU industry;
- (c) Attracting investments and increasing the availability of financial resources for industrial enterprises;
- (d) Elimination of barriers to the movement of industrial goods on the common EAEU market;
- (e) Innovative modernization of industrial complexes, and new cooperative chains for high-tech industrial products, in demand on world markets;
- (f) Business motivation and its stimulation to establish joint dealer and service networks, authority engineering products and

technical support, special combined sales companies and consortia.

The above-mentioned directions also establish a list of priorities and sensitive products which allow the member states to concentrate on the most important industries. Sensitive goods⁴¹ with a high level of competition among producers from the EAEU member states encompass metallurgy, automobile production, machinery and equipment for agriculture and forestry, construction materials and light industry.

For instance, the norms of the Supreme Eurasian Economic Council decisions №72⁴² (29 May 2014) to determine the conditions of industrial assembly for motor vehicles on the territory of the Customs Union and Common Economic Space undoubted-

⁴⁰ Промышленная политика ЕАЭС: от создания к первым результатам (Industrial Policy of the EAEU: From the Creation to the First Results), ed. S.S. Sidorskiy, Moscow, 2015, 36.

⁴¹ Osnovnie Napravleniya Promishlennogo Sotrudnichestva v Ramkax Evraziyskogo Ekonomicheskogo Soyuza (Main Directions of the Industrial Cooperation within the Eurasian Union)," http://www.eurasian-commission.org/ru/act/prom_i_agroprom/SiteAssets/6poшyopa%20pyc%20OK%20NEW.pdf

⁴² "Reshenie Visshego Evraziyskogo Ekonomicheskogo Soveta ot 29 Maya 2014 goda (Decision of the Eurasian Economic Council on May 29, 2014)," http://online.zakon.kz/Document/?doc_id=31576610#pos=0;277.

ly affect the interests of **Kazakhstan**. Paragraph 2 obliges Kazakhstan and Belarus to terminate the conclusion of new agreements with respect to motor vehicles on several commodity items 60 days after the decision entered into force.

Another provision in the document is Subparagraph 4 of Paragraph 1 which provides the possibility of increasing the quota for industrial assembly projects, but only for Belarus and in agreement with the Russian Federation. In this regard, Kazakhstan's MP Kenes Absatirov (Ak Zhol Majilis faction) initiated an inquiry to eliminate discrimination against Kazakh mechanical engineering in the EAEU. He doubted that this it was good for modernization when an economy was made dependent on the production in the own country which is not a leader in world technology. "Since when is Lada considered smarter and more innovative than Toyota or Mercedes", the Kazakh MP argued.⁴³ Such measures are related to the harmonization of WTO and EAEU agreements to establish equal production conditions for all manufacturers within the EAEU. However, this issue has not been properly discussed as the agenda is highly politicized.

In this regard, the basic principles of the Union, such as equality and mutually beneficial cooperation, have been constantly challenged and predominantly by Russia. For instance, Russia unilaterally banned the import of products to its territory from Belarus and Kazakhstan. In addition, during political disagreements and tensions, the Federal Service for Surveillance on Consumer Rights Protection and Human Wellbeing (known as Rospotrebnadzor) has been acting as punitive agency which without proved evidence introduced a ban on EAEU member states' products. Also, Rospotrebnadzor imposed a ban on the transit of goods from Ukraine and Turkey through its territory, which were supposed to go to Kazakhstan.

⁴⁴ Such political decisions and unilateral actions

⁴³ "Ustranit Diskriminatsiyu Kazaxstanskogo Mashinostroeniya v EAES Poprosili Sagintaeva (Sigintaev was Asked to Solve the Discrimination in the Machinery Industry)," <https://informburo.kz/novosti/ustranit-diskriminatsiyu-kazaxstanskogo-mashinostroeniya-v-eaes-poprosili-sagintaeva.html>.

⁴⁴ "Rospotrebnadzor Nachinaet Izimat Turetskie I Ukrainskie Produkti s 1 Yanvarya (Rospotrebnadzor Will Prohibit Turkish and Ukrainian Products from January 1)," <http://www.zakon.kz/4765088-rospotrebnadzor-nachnet-izymat-tureckie.html>.

very clearly contradict the idea of the EAEU.

During crisis in 2015 and 2016 Kazakhstan remained the only EAEU member state which preserved growth in the manufacturing industry. The former Minister for Investment and Development of the Republic of Kazakhstan Zhenis Kassymbek reported to President Nazarbayev the results of industrialization for the first half of 2016.⁴⁵ However, Kazakhstan's light industry in 2016 lost 27% of its active companies. During that year, the physical volume of production declined by 1% compared to a growth of 3.4% in 2015.

Almost all textile and footwear products which are consumed by Kazakhstanis are imported.⁴⁶ In this regard, the process of import substitution in non-food consumption is rather slow and does not comply with and correspond to the EAEU declared goals. The same situation can be traced in Belarus, Russia and Kyrgyzstan as well.

Regarding **Kyrgyzstan**, there are several points that should be highlighted while assessing the impact of EAEU accession. For instance, Kyrgyzstan's food industry should become even more competitive in terms of transition to EAEU quality standards. Sultan Akhmatov, Head of the Technical Regulation and Metrology Department of the Ministry of Economy, considers the Kyrgyz food industry 80% ready for this transition.⁴⁷ However, before August 2017 the Kyrgyz government had to introduce 18 technical regulations which set requirements for product quality. They had to provide respective information to private and state-owned enterprises and work hard to meet these norms. And this process takes time and financial resources.

⁴⁵ "Kazaxstan Ostaetsya Edinstvennim Chlenom EAES, Soxranyayushim Rost v Obrabativayushiy Promishlennosti (Kazakhstan Will Remain the Only Member of the EAEU, Which Sustain the Growth of the Refining Industry)," <https://www.zakon.kz/4803215-kazakhstan-ostaetsya-edinstvennym.html>.

⁴⁶ "Legkaya Promishlennost Kazaxstana za 2016 God Poteryala 27% Aktivnix Predpriyatiy (Light Industry of Kazakhstan Lost 27% of Its Production Facilities in 2016),"

<https://radiotochka.kz/31348-legkaya-promyshlennost-kazaxstana-za-2016-god-poteryala-27-aktivnyh-predpriyatiy.html>.

⁴⁷ "Pishevaya Proishlennost Krygzystana na 80% Gotova Rabotat v Ramkax EAES (Kyrgyzstan's Food Industry Is Ready to Work Within the EAEU for 80%)," <https://ru.sputnik.kg/video/20170413/1032867119/pishchevoe-proizvodstvo-kyrgyzystana-na-80-gotovo-prinyat-standarty-eaehs.html>.

It is said that the textile and garment industry has become the most beneficial after Kyrgyzstan joined the EAEU. In 2016, the volume of production increased by 44.6 mln Kyrgyz Som compared to 2015, amounting to 5.2 bln Kyrgyz Som. According to the Kyrgyz prime minister, the country's textile and garment industry is currently providing more than 150,000 jobs.⁴⁸ Kyrgyzstan also plans to gain new opportunities to export textile and apparel products to the EU market as well as to those countries which have a free trade zone agreement with the EAEU and to establish the well-known brand "Made in Kyrgyzstan". Kyrgyzstan's largest textile factory has been put into operation in October 2016. Starting from 10 tons of tissue daily, the plans are to bring this volume up to 40 tons with cotton and natural dyes imported from Uzbekistan. This US\$ 200 mln project was supported by the Russian-Kyrgyz Development Fund, like many other projects in this industry.⁴⁹

Even **Tajikistan's** possible accession to the EAEU could increase the demand for and, accordingly, export of its main export goods, e.g. aluminium. However, the O. Deripaska RUSAL company announced its plans to conserve part of its production capacity due to a drop in the price and demand for aluminum on world markets.⁵⁰ In this regard, it is not clear how the demand for Tajik aluminum will grow after the country joined the EAEU. However, according to recent data, aluminum as "best performing metal"⁵¹ might stir Chinese investments. This case applies for other industries as well, when analyzing Tajik costs and benefits as an EAEU member.

In addition, Tajikistan's accession to the EAEU could possibly strengthen Tajik-Uzbek relations, which have deteriorated due to the Rogun dam project.⁵² Also Tajik experts⁵³ consider the EAEU

48 "Kyrgyzstan's Textile and Clothing Industry In 2016," <http://easttime.info/news/kyrgyzstan/kyrgyzstans-textile-and-clothing-industry-2016>.

49 "Major Textile Factory Opened in Kyrgyzstan," <http://easttime.info/news/kyrgyzstan/major-textile-factory-opened-kyrgyzstan>.

50 "Tadjikistan i EAES: Bili i Nebilici (Tajikistan and the EAEU: Realities and Myths)," <https://www.rimneurasia.org/news-2017-03-28-tadzhikistan-i-eaes-byli-i-nebylitsy-29215>.

51 Aluminium emerges as top performing industrial metal in 2017," <https://www.ft.com/content/a20a9edc-28df-11e7-9ec8-168383da43b7>.

52 Note: Rogun is planned dam to be located on the upstream Tajikistan, which is also capable of affecting the level of water discharges for downstream Uzbekistan.

53 "Tadjikistan v EAES – Opasnost i Alternativi (Tajikistan in the EAEU:

as a mechanism that would be able to remove the existing contradictions between Tajikistan and Uzbekistan.

Comparing the economic potential of the EAEU member countries and the benefits they can expect from different integration-related projects shows a "multi-speed Eurasia". Six out of ten EAEU biggest infrastructure projects are currently being implemented in Russia, including infrastructure for the World Cup in 2018 (US\$ 8.15 bln).⁵⁴ The country's dominance is reflected not only in the quantity but also in the volume of the accumulated mutual FDI. In 2015, Russia attracted a vast 84% of mutual FDI flows in the region. Kazakhstan is placed second with only 9%.⁵⁵

2.3 Silk Road Economic Belt: Russian Roulette?

Assessing the SREB impact on Central Asia shows that Central Asian states prefer pragmatic bilateral relations with Beijing to Russia-led EAEU integration. The SREB does not envisage any supranational bodies or obvious political agenda.

Countless attempts and discussions to merge the EAEU and the One Belt One Road (OBOR) initiative have resulted in a memorandum on cooperation in 2015. However, the situation has not been changed. On the one hand, it is said that the Kremlin and Beijing have not agreed on a division of labor. While on the other hand, Russia is trying to actively participate in Belt and Road infrastructure and transit projects to boost its own economic development. As for the Central Asian states, the SREB has nothing to do with their industrial development. Focusing on infrastructure, the initiative rather tends to enhance Chinese opportunities and positions in the region than to assist Central Asia's strategic develop. Expectations to accelerate economic growth by bridging the "infrastructure gap" are too high.

Threats and Alternatives)," <http://www.ca-portal.ru/article:34193>.

54 "10 Krupneyshix Infrastrukturnix Proektov EAES (The EAEU's 10 Biggest Infrastructure Projects)," *Eurasia Expert*, May 18, 2016, <http://eurasia.expert/infrastrukturnye-proekty-eaes/>.

55 "Monitoring of Mutual Investments in CIS Countries 2015," Eurasian Development Bank Centre for Integration Studies Report, August 2015, 54.

In the Central Asian states and Kazakhstan, in particular, bilateral relations with China are perceived as integral for the participation in the SREB initiative. There is no competition between the EAEU and the SREB in Central Asia. The latter represents an easy access to investments during the conditions of economic crisis. In this regards, the attractiveness of SREB is much higher than that of the EAEU which comes with a complex organizational structure and common goals and policies.

For instance, **Tajikistan** plans to considerably boost its cotton production and textile industry which could lead to new jobs, an increase of the GDP and wages and a reduction of the level of radicalization among the local youth. Tajikistan is expecting important investments from the EAEU, particularly in the hydropower and banking sector. It's no secret that Tajik authorities are concerned over joining the EAEU as it may negatively affect the level of Chinese economic assistance.⁵⁶ Chinese investments have been vital for the development of the country's economy so far.

In 2016, the volume of foreign direct investment in Tajikistan reached US\$ 354.4 mln. That is 15% more than in 2015. The main areas of FDI include steel construction, industry, communications, geological exploration and mineral resources. And China is the leader in FDI with a share of 62%. The total amount of grants which China allocated to Tajikistan in the past three years has reached 1.2 bln yuan.⁵⁷

In exchange for investment in the country's energy infrastructure the government of Tajikistan provides China with a license to develop rare-earth and precious metals deposits. In 2014, for instance, the Tajik government gave the Chinese company TBEA a right to conduct exploration work on two gold deposits in the Sughd region in exchange for the construction of the Dushanbe TPS-2 (about US\$ 30 mln). And in 2016 TBEA received approval and began developing the gold deposits "**East Duoba**" and "**Upper Kumarg**" in the same area.⁵⁸

56 "Tadjikistan v EAES – Opasnost I Alternativi (Tajikistan in the EAEU: Threats and Alternatives)," <http://www.ca-portal.ru/article:34193>.

57 "Kitay Stal Osnovnim Investorem Tadjikistana (China Became Major Investor in Tajikistan)," <http://www.easttime.ru/news/tadzhikistan/kitai-stal-osnovnym-investorom-tadzhikistana/12477>.

58 "Zolotaya Lixoradka: Kak Kitay Bogateet za Schet Tadjikskix Dragme-

According to an agreement "On demarcation of the border and settlement of territorial disputes,"⁵⁹ Tajikistan transferred to China an area of about thousand square kilometers in the Murgab district in the Pamir (huge reserves of silver, lead, tin, semiprecious and precious minerals) where Chinese companies are currently working. There is also a growing trend for the Chinese language among young Tajiks. The Confucius Institute has become a good promoter of Chinese "soft power" and education in the country.⁶⁰ More and more students prefer to go to study in China and get employed in Chinese companies. In this regard, in short-term perspective China could potentially replace Russia from its top position in employing Tajik migrants.

As for **Kazakhstan**, there is a certain dual attitude towards SREB. While the authorities always mention great prospects of new industries, Kazakhstanis express concerns over increasing economic dependence on China. And when people heard about plans to transfer 51 Chinese enterprises to Kazakhstan's territory they reacted afraid. There were rumors that these are "dirty" factories which pose environmental threats.⁶¹ These fears are quite arguable, as part of the production refers to engineering and energy, chemistry and metallurgy. Recently, Kazakh media reported on the construction of a chemical and metallurgical complex in Pavlodar. The construction is planned for 2017, but no precise information about the plant can be found publicly. The same point refers to other China-financed industrial projects in the country.

In 2015 President Nazarbayev himself announced the transfer of Chinese enterprises to Kazakhstan. Later "transfer" was replaced in official rhetoric

tallov (Golden Fever: How China is Gaining Benefits from Tajik Precious Metals)," <http://ru.sputnik-tj.com/analytics/20170317/1021878886/dragmetally-kr-nedra-pamir-tadzhikistan.html>.

59 "V Pekine Podpisan Protokol Mejdru Pravitelstvami Tadjikistana I Kitaya o Demarkatsii Liniy Tadjiko-Kitayskix Gosgranic (Protocol on Border Demarcation Between China and Tajikistan Was Signed in Beijing)," <http://news.tj.ru/news/tajikistan/20100429/v-pekin-podpisan-protokol-mezhdu-pravitelstvami-tadzhikistana-i-kitaya-o-demarkatsii-linii-tad>.

60 "Kitayskaya Gramota: Yaxik kak Propusk Tadjiskoy Molo-deji na Rabotu v KNR (Chinese Award: Language as a Pass for the Tajik Youth to Work in China)," <http://ru.sputnik-tj.com/opinion/20170525/1022411502/kitayskiy-yazyik-molodezh-ekonomika-rabochie-mesta-tadzhikistan.html>.

61 "Kitay Perevedet v Kazaxstan 51 Predpriyatie (China Will Move 51 Production Facilities to Kazakhstan)," https://forbes.kz/finances/markets/kitay_perevedet_v_kazahstan_51_predpriyatie.

with “implementation of investment projects”. According to Baltabai Syzdykov,⁶² 12 projects in manufacturing industry have been launched in 2017. The biggest ones are the construction of a copper smelting plant in the East Kazakhstan region, a polypropylene plant in the Atyrau region and the modernization of the Shymkent oil refinery. It is expected to create 15,000 jobs, as well as significantly improve the skills of Kazakh workers.

For **Kyrgyzstan**, as well as other Central Asian states, including **Uzbekistan**, closer cooperation with China can be enhanced by transit and transport corridors. The most attractive industries for Chinese investors are manufacturing industry (27.74% of its total FDI); trade, repair of motor vehicles, household goods and personal items (7.95%); financial investment in transport and communications (3.16%). Certain Kyrgyz experts noted that one should carefully study the conditions and calculation formula for Chinese loans and credits as the investments which must be paid with interest. About one-third of Kyrgyz external debt (approximately US\$ 1 bln) are commitments to China.⁶³

While the SREB Initiative does not stand for industrial development, the initiative would reconnect China with Eurasia, including Central Asian states. The SREB shows no integration agenda. It is aimed at deepening bilateral relations of Central Asian countries with China in areas of Chinese strategic interest not Central Asian ones. The SREB as well as the EAEU provide poor opportunities for industrial development. On one hand, it has become clear that the SREB mainly represents Chinese interests in regional natural resources. On the other hand, the EAEU is clearly a Russia-dominated integration project and the high goals for a common industrial policy are not met. Neither the EAEU nor the SREB provides Central Asian states with opportunities and resources to develop their industries, not to mention an effective regional cooperation.

62 “Kitay Vitesnyaet Rossiiu iz Tsentralnoy Azii – Experti (China Is Pushing Russia out of the Region – Experts),” <https://365info.kz/2017/05/kitaj-vytesnyaet-rossiiu-iz-tsentralnoj-azii-eksperty/>.

63 “Kitay i Kirgizstan: Osnovnie Vizovi i Tendentsii Sotrudnichestva (China and Kyrgyzstan: Main Risks and Cooperation Trends),” <http://www.stanradar.com/news/full/20277-kitaj-i-kyrgyzstan-osnovnye-vy-zovy-i-tendentsii-sotrudnichestva.html>.

3. Integration of the Energy Markets: EAEU Institutional Capacity to Complement the Ambitions of SREB?

Energy resources are often prioritized within both the EAEU and the SREB initiatives. Yet, the strategic importance of the energy resources is both a blessing and a curse when it comes to attracting investments and securing sustainability of the energy relationships. The bilateral forms of negotiations proved to be quite effective for greater powers to promote their interests in the region as well as for local rent-seeking elites. The analysis shows, however, that bilateral and trilateral forms of arrangements may not possess effective tools to ensure sustainability of energy sector development and reliability of energy interactions both within the EAEU and the SREB.

3.1 Institutional Capacity of the EAEU

Moscow has a long history of determining the energy policy and energy interactions in the post-Soviet space, including the Central Asian region. When Russia lost its political control over the newly independent Central Asian countries' energy resources, parties continued engaging in energy supply relationships on a bilateral basis. In an attempt to strengthen interdependencies and establish reliable trading patterns, some of the Central Asian countries agreed to take part in integration processes promoted by Russia, which also included the strategically important energy sector. The most visible achievement of this initiative so far has been the establishment of an institutional apparatus to set up a conceptual framework to guide member states along the process of energy market integration.

The EAEU has inherited a mechanism developed by the institutions which represent earlier stages of the economic integration in the region – the Eurasian Economic Community (EurAsEC) and the Customs Union (CU). The Council on Energy Policy, within the EurAsEC and now the EAEU, is the main agency responsible for the development and implementation of regional-level energy projects.

Along with the Council on Energy Policy⁶⁴ the other agencies involved in the process of establishing a unified energy system are: (a) the Electricity and Nuclear Policy Department; (b) the Oil and Gas Policy Department; (c) the Advisory Committee for Electricity; and (d) the Advisory Committee for Oil and Gas. The Advisory Committee for Oil and Gas established in 2012 is, for instance, responsible for Eurasian Economic Commission board proposals concerning the development of common energy policies in the field of oil and gas, energy markets, determining the bases for pricing and tariff policy in the field of gas transportation.

All these agencies, in close cooperation with national level governmental institutions, aim at:⁶⁵

- (a)** developing mutually beneficial cooperation in the energy sector and joint efforts to establish the common energy market;
- (b)** adequately supplying the internal market with energy resources and increasing exports to third countries;
- (c)** establishing a wholesale market of electricity;
- (d)** rationally using water, fuel and energy resources;
- (e)** extending cooperation in developing, processing, and exporting new hydrocarbon resources;
- (f)** developing transit potential;
- (g)** ensuring energy security and creating conditions for stable economic growth.⁶⁶

3.2 Lack of Regional Governance Mechanism within the SREB

Differently from the EAEU, Chinese initiatives do not have “physical bodies” – institutional mechanisms to create regional common energy markets and ensure regulations. The newly introduced

⁶⁴ Eurasian Economic Community, *Fundamentals of Energy Policy of the Eurasian Economic Community* (Moscow: Eurasian Economic Community, 2003), <http://evrazes.com/docs/view/152>.

⁶⁵ Eurasian Economic Commission, *EEC Advisory Committee for Oil and Gas Held its First Meeting* (Moscow: Eurasian Economic Commission, 2013), <http://eurasiancommission.org/en/nae/news/Pages/65464654.aspx>.

⁶⁶ Eurasian Economic Commission, “Fundamentals of Energy Policy.”

SREB initiative is merely a program which attempts to strengthen the bonds among countries along the road, without having a single organizational structure. To pull state actors together into regional cooperation Chinese authorities could use the institutional mechanism of the Shanghai Cooperation Organization. Yet, even within the SCO member states lack effective enforcement mechanism to ensure reliability of energy relations.

Chinese interest in the energy resources of the Central Asian region has always been dictated by its energy needs. Having experienced a strong thirst for oil back in the late 1990s, China started to show even greater interest in the oil sector of Kazakhstan. When natural gas consumption exceeded its domestic production level in 2000s, Chinese authorities also turned to the Central Asian region as a potential supplier.⁶⁷ Yet, the only agency created specifically to deal with energy relations over the past almost two decades is the Energy Club. The Energy Club was officially established in 2013 when member states signed a memorandum. Without having an effective enforcement mechanism, China and its Central Asian counterparts set up quite ambitious goals which are expected to come out of their cooperation in the energy sector:

- (a)** stable and reliable energy supplies for the population and economic needs of the participating states in the Asian energy strategy – adequate energy supplies during stable conditions and minimal energy supplies in case of emergencies;
- (b)** Renewable Energy Sources (RES) development (providing balance between fossil fuels and RES);
- (c)** diversification of energy sources (decreasing extensive dependence on a single energy source);
- (d)** respect for environmental concerns;
- (e)** energy efficiency and conservation;
- (f)** development of economic conditions to ensure the most cost efficient way of energy supplies to internal and external markets

and rationalizing the structure of energy export; and

- (g)** innovative technologies being employed in the energy sector of the SCO member states.⁶⁸

However, the analysis shows that currently energy cooperation within the SCO and now the SREB is not developing in all the above-mentioned directions as Central Asian states have been expecting. Negotiations are mostly hold in a bilateral format and Central Asian elites try to use Chinese initiatives and programs to diversify their dependence on Russia, while China seeks access to the region's resources and secure stable energy import. According to the Russian deputy minister of Energy Anatoliy Yanovskiy, the main objective of the only energy agency, the Energy Club, is to form recommendations to the organization's member states on how to behave in dynamically changing regional energy markets. The Club's decisions do not have enforcement power.⁶⁹ The SREB is also only an initiative which links projects in single countries. For that fact, the SREB might be even more attractive to some of the Central Asian countries than the EAEU, because it does not impose membership in the organization.

Bilateral agreements can therefore be considered quite a strong instrument in China's possession, as they help to overcome political obstacles in running energy projects which go beyond the scope of one state. It is difficult for a regional initiative to sustain reliable relations among its member states without an effective regional mechanism which again requires some sort of institutional tools. If, for example, Russian and Chinese initiatives were merged, Central Asian producers could, to some extent, take advantage by using institutional mechanisms of the EAEU to also pursue ambitious goals within Chinese initiatives. So far, unfortunately, regional initiatives failed to establish a truly multilateral format of negotiations and sustainable regional platform to secure reliable energy relationships.

⁶⁷ Kazakhstan-China oil Pipeline, *Kazamunaigaz official website*, n.d., http://www.kmg.kz/en/manufacturing/oil/kazakhstan_china/.

⁶⁸ International Scientific Conference Materials, *The SCO in Quest of New Perception of Security*, 121.

⁶⁹ "SCO Member States Agreed to Establish Energy Club," *Kazenergy*, December 9, 2013, <http://kazenergy.com/ru/pre ss/2011-04-21-10-41-35/12013-2013-12-09-04-09-08.html>.

For China, regional energy projects in Central Asia are a matter of energy security, thus strategically important. Those projects are not only being implemented fast, but also show a high quality. In fact, the Central Asia China Gas Pipeline was the winner of China's Golden Award for Construction Excellence.⁷⁰ China is both interested in running energy facilities to their full capacities and recoup investments. However, the problem of corruption and risk of excessive dependence on Chinese loans are raising concerns among the population. They may negatively affect the reliability of energy supplies and complicate the further enhancement of connectivity. However, the SREB initiative will turn China into one of the most important players in the Eurasian region and therefore it will most likely have to deal with sensitive and risky regional projects in energy relations.⁷¹ For example, none of the regional and global actors has so far dared to actively engage in resolving the water-energy nexus problem in the region. Central Asia is roughly divided into upstream and downstream countries. Oil and gas rich downstream countries used to be major energy suppliers to upstream states which were again responsible for releasing water along the two major transboundary rivers for irrigation purposes of their downstream neighbors. Conflict over the resource sharing mechanism has resulted in crisis of relationships between downstream Uzbekistan and upstream Tajikistan and Kyrgyzstan. Such tensions may affect the construction of the Line-D Central Asia China Gas Pipeline and risk stability of gas supply.

The fact that Turkmen and Uzbek gas is currently transported to China through Kazakh territory only adds strategic importance to the Line-D pipeline, because the Chinese feel uncomfortable completely depending on Kazakhstan's pipeline infrastructure. Line-D is designed to move Turkmen gas through Uzbekistan, Tajikistan and Kyrgyzstan to China, with a capacity of 30 bcm per year. However, the conflict between Uzbekistan and the upstream countries may negatively affect any sort of swap arrangements to move and trans-

mit gas within Central Asia. Construction of Line-D started in 2014 in Tajikistan. However, there have been many delays with the construction. And the water-energy nexus challenge may further delay the implementation of the project.

Addressing water-energy nexus problems is directly linked to the construction of the large Hydro Power Plants in the upstream Central Asian states. For instance, up until recently, it was expected that Russia would be the one to build large hydro power plants (HPP) in the country. In 2012, Russia committed to invest US \$ 2.1 bln in the construction of 4 Upper Naryn cascade (200 MW) and Kambarata-1 HPPs (1.9 GW), which would have most likely be implemented under the umbrella of the EAEU. However, in December 2015 Atambaev suggested that the parliament should denounce the agreement, because Russia could not comply with all necessary requirements due to economic difficulties. The agreement was denounced in January 2016. China could have taken over Russia's place, as it has extensive experience in building large HPPs and has the money to do it. Yet, China does not take part in controversial projects, such as Kambarata-1 in Kyrgyzstan or Rogun in Tajikistan. However, the Chinese role in regional energy geopolitics increases and this may anyway drag China into disputes over the sharing of water and energy in Central Asia, as this affects the overall energy supply stability in the region. To address this problem China might have to reconsider its bilateral arrangements with the Central Asian energy producers and develop a multilateral format of negotiations within the SREB initiative.

Observing the rapid growth of Chinese influence in Central Asia, Russian authorities realized that it is no option to ignore China as a player who develops the Central Asian energy sector and that they should rather secure the trading dynamics in Eurasia. On May 8, 2015 Vladimir Putin and Xi Jinping signed a Joint Statement indicating the harmonization of the SREB and the EAEU.⁷² While both initiatives can potentially merge and complement certain weaknesses in regional energy programs, sensitive projects can only be addressed

70 "CNPC in Uzbekistan," *CNPC website*, n.d., http://www.cnpc.com.cn/en/Uzbekistan/country_index.shtml.

71 "Xinjiang Trade Raises Doubts Over China's 'Belt and Road' Plan," *Financial Times*, August 18, 2016, <https://raffaellopantucci.com/tag/silk-road-economic-belt/>.

72 Tian Shaohui, "China, Russia Agree to Integrate Belt initiative with EAEU Construction," May 9, 2015, http://news.xinhuanet.com/english/2015-05/09/c_134222936.htm.

when every actor is willing to reconsider the energy policies of national elites.

3.3 Regional Initiatives without Common Energy Markets

The energy sector is strategically important for the EAEU member states, including and perhaps most of all for Russia. Within the EAEU intermediate goods account for 85.9% of the total export and 59.1% of all exported goods are energy products.⁷³ Also Russian capital investment is dominantly directed to hydrocarbons. 47% of all Russian foreign direct investment in the EAEU goes to this sector.⁷⁴ So, the energy sector is important for Russia, but it refrains from establishing a common energy market. Fear of losing control over the movement of energy resources and refined products prevents Russia from facilitating the integration of energy sectors within the EAEU and engage non-member states in joining a common energy market.

The EAEU member states have listed the heavily traded goods of mineral fuels, mineral oils and products of their distillation in a tariff group (Group 27) which still is excluded from the EAEU custom tariff free regulation.⁷⁵ One could argue that Russia opposes the removal of these custom tariffs for economic reasons. But the fact that the annually renewed bilateral agreements with Belarus, Kazakhstan and now Kyrgyzstan already to some extent exclude export tariffs for oil products, gas and electricity,⁷⁶ implies that Russia rather wants to maintain political leverage (threat of declining the renewal of contracts).

As not all Central Asian countries are members, a regional energy governance mechanisms in the

EAEU could not include all intergovernmental interactions. At the moment, only Kyrgyzstan and Kazakhstan are members of the EAEU. Tajikistan is a potential candidate. Two key players – Uzbekistan and Turkmenistan – are not considering accession to the organization. Russian authorities try to involve the outsiders into broader energy interactions through bilateral agreements. For instance, Russian authorities are highly interested in keeping Uzbekistan within Russia's sphere of influence. New Uzbek president Shavkat Mirziyoyev's first visit to the Russian Federation resulted in the signing of over 50 official documents over US\$ 15.8 bln of investment. A considerable part of it will be spent in the energy sector.⁷⁷ In this regard, one can extend the analysis of the energy interaction within the EAEU to the broader Central Asian region.

The terms of the EAEU came into force on January 1, 2015. Within the EAEU framework member states use a single-mechanism which creates unified energy, transport and communication infrastructure, regulates the harmonization of their economic legislation, a coordinated tax system and a trade and customs policy which is aimed at ensuring the free movement of goods, services, capital and labor force. But the program for the establishment of a common energy market will only be developed, if all goes according to plan, by 2018. It is also expected that the common electricity market within the EAEU will be formed by 2019 and the oil and gas market only in 2025. The liberalization of energy markets should be accompanied by a harmonization of laws between the Union member states and the establishment of supra-national financial centers to implement regional-level energy projects.⁷⁸ Even though the Russian government applies preferential energy pricing and a customs tariff-free policy toward members of the Union, in the absence of an effective and multilateral mechanism designed to ensure free movement of energy resources, most of the EAEU member states will remain vulnerable to politically motivated Russian energy policies.

⁷⁷ Stanislav Pritchkin, "Dolgaya Doroga v Pekin (A Long Way to Beijing)," *Nezavisimaya*, May 15, 2017, http://www.ng.ru/dipkurer/2017-05-15/11_6987_uzbekistan.html.

⁷⁸ Eurasian Economic Commission, "Important Events in the Activity of the Department of Energy," 2014, <http://eurasiancommission.org/ru/act/energetika/ener/events/Pages/default.aspx>.

⁷³ Evgeny Vinokurov, "Eurasian Economic Union: Current State and Preliminary Results," *Russian Journal of Economics* 3 (2017), 17.

⁷⁴ Evgeny Vinokurov, "Eurasian Economic Union: Current State and Preliminary Results," *Russian Journal of Economics* 3 (2017), 63.

⁷⁵ Eurasian Economic Commission, *Gruppa 27: Toplivo Mineralnoe, Neft i Produkty ix Peregonki; Bituminoznie Veshstva; Voski Mineralnie* (Group 27: Mineral Fuels, Oil and Products of its Distillation; Bituminous Substances; Mineral Waxes) (Moscow: Eurasian Economic Commission, n.d), <http://www.tsouz.ru/db/ettr/PSN/Pages/psn27.aspx>.

⁷⁶ "Putin Podpisal Ratifikatsiyu Dogovora o Besposhlinnix Postavkax Nefteproduktov v RK (Putin Ratified An Agreement on Customs Free Supplies of Oil Products to RK)," *Azattyk*, December 29, 2016, <http://rus.azattyk.org/a/28203717.html>.

Russia is supplying Kyrgyzstan and Tajikistan with discounted oil products to keep them largely under its sphere of influence. The shortcoming of such relationships is the lack of reliability and sustainability of the energy supplies. Russia is exporting oil products to Central Asian upstream countries based on annually renewed contracts. Russia could simply suspend the relationships and refrain from renewing the contracts. In this case, Tajikistan and Kyrgyzstan, which extensively rely on Chinese loans, might end up in a vulnerable position. Excessive dependence on Chinese investments to the oil and gas sector in Central Asian upstream countries also bears political and economic risks for them. Tajikistan and Kyrgyzstan would be a lot safer in terms of energy security (ability to meet domestic needs for oil products), if energy initiatives to develop domestic resources are combined with intra-Central Asian energy trade. This, however, is a quite sensitive issue for regional actors.

President Vladimir Putin has ratified an agreement between Russia and Kyrgyzstan regarding the supply of tariff-free oil and oil products to the Kyrgyz market. Parties are negotiating the volume and types of Russian oil products which are to be exported to Kyrgyzstan.⁷⁹ Because the supply relationships between Russia and Kyrgyzstan are not entirely clear, the latter is seeking alternatives. China is even seen by the Kyrgyz authorities as an alternative supplier of oil products to replace Russian goods.⁸⁰

3.4 No Unified Position Over Key Energy Concepts

One of the challenges preventing actors from engaging in regional cooperation and developing regional energy governance mechanisms is the lack of a united position over several sensitive and important energy issues. The EAEU member states pursue energy resources differently depending on whether they hold the status of importing or exporting country. Russia is clearly an exporter

79 "Putin Podpisal Ratifikatsiyu Dogovora o Besposhlinnix Postavkax Nefteproduktov v RK (Putin Ratified An Agreement on Customs Free Supplies of Oil Products to RK)," *Azattyk*, December 29, 2016, <http://rus.azattyk.org/a/28203717.html>

80 Chris Rickleton, "Central Asia Rues Dependency On Russian Fuel," *Eurasianet*, October 6, 2014, <http://www.eurasianet.org/>.

and other member states depend on the import of its energy sources. Importing countries pursue energy resources as a market commodity similar to other products. They want to receive those resources for the lowest price possible and then further have them on their disposal. Exporters, in contrary, consider energy as a strategic commodity and in addition to economic gains want to use it to gain political and security leverage. Russia, for instance, being the largest supplier of energy and refined products in the region uses export-tariff free relations with importers to keep them under its sphere of influence. Kyrgyzstan and Belarus are very good examples of it.

Kazakhstan is both an importer and exporter of energy resources. As an importer of energy resources it votes for the liberalization of oil, gas and electricity markets, which would allow it to import oil products and electricity without custom tariffs from Russia. Despite the fact that Kazakhstan is also an exporter of energy resources, Kazakh authorities to a large extent remain in favor of the creation of a common energy market. Export of oil and gas is the driving force of Kazakh economy, which generates 25% of its GDP and more than 70% of its overall export. Kazakhstan is less interested in exports to other Union member states, where Russian products already dominate. It focuses on external markets.⁸¹ Kazakhstan wants to export its oil, 70% of which goes to Europe passing Russian territory, free of tariffs and therefore needs a common oil and gas market. Other member states of the EAEU, including **Kyrgyzstan**, are also highly interested in establishing a common energy market which will allow them to enjoy tariff-free and therefore cheaper access to Russian hydrocarbons and refined products.

Within the SREB initiative China promotes connectivity by constructing infrastructure and enhancing trading dynamics, which also implies integrating the development strategies of the countries.⁸²

81 "Neftegazovaya Otrasl Obespechivaet 25% VVP RK: Dobicha Nefiti v Kazaxstane Virosla Bolee Chem v Tri Raza (Oil and Gas Industry Provides 25 percent of GDP of Kazakhstan: Oil Production in Kazakhstan Increased Three Folds)," *Kapital.kz*, 2013, <http://kapital.kz/economic/21860/neftegazovaya-otrasl-obespechivaet-25-vvp-rk.html>

82 Alessia Amighini, "China's Belt and Road: A Game Changer?" *ISPI*, 2017, 15, http://www.ispionline.it/it/EBook/Rapporto_Cina_2017/China_Belt_Road_Game_Changer.pdf.

Formal and informal barriers for mutually beneficial trading dynamics could be reduced by a regional platform and institutional mechanism. China has been developing its foreign policy towards post-independence Central Asian states within the framework of the “Zhoubian Zhengee” political strategy or periphery policy.⁸³ When it comes to energy export–import relations, however, Central Asian states are not peripheries, but partly important energy suppliers to China. Still, China often engages in the dialogue with Central Asian countries with different expectations. This prevents them from reaching consensus on a number of issues and developing an energy strategy as well as action plans on the further implementation of regional-level energy projects.

In 2007, during the second session of the Eurasian Economic Forum in Xi'an, China, the SCO secretary general Bolat Nurgaliev stated that “for the time being the member states of the Shanghai Cooperation Organization do not have a united position over the common strategic energy concept.”⁸⁴ After a round of negotiations during the summit, heads of the energy ministries of all member states failed to formulate a single SCO energy policy. Member states agreed to use expert-level discussions to develop a strategy which is amenable to all.⁸⁵ China and the Central Asian states still do not have a united position over the water-energy nexus, energy security of the producing countries, export-import balance, or the latent competition between China and any other customer for Central Asian energy resources. China is trying to get access to as much energy as it possibly could and recoup its investments, while Central Asian counterparts aim at securing the demand for their energy resources at the highest possible price. Without reaching common understanding on these issues, it is impossible to develop a common energy strategy and follow it thoroughly, create an enforcement mechanism and secure reliability of energy supplies.

Different from its Russian counterpart, Chinese authorities seek stable and large-scale energy import to meet its domestic energy needs. China is also not interested in promoting liberalization and integration of the Central Asian energy markets unless it helps the former to secure stability of energy supplies. The Chinese authorities perceive energy as a strategic commodity. The energy sector accounts for the majority of Chinese investments in Central Asia. But they do not serve the purpose of liberalizing the energy market and improve the level of energy security in Central Asia.

During the visit of the President of **Turkmenistan** Gurbanguly Berdymukhamedov to the People's Republic of China on July 17, 2007, the two parties signed the Production Sharing Agreement on the development of the Bagtiyarlik on the Amu Darya river territory. China is obliged to develop the field and build infrastructure and gas processing plants. This was an important precondition of to build the Turkmenistan-China gas pipeline two years later.⁸⁶ China provided US\$ 8 bln in loans in 2011 for the development of the Galkynysh gas field⁸⁷ and has been continuously supporting construction of the longest pipeline infrastructure in the world.⁸⁸ According to official statements, there is an overall agreement among the heads of states that “reliable and mutually beneficial partnership in the energy sector strengthens security and stability across the SCO region.”⁸⁹ This partnership (among producing, transit and consuming states), however, is limited to ensuring the stability of moving energy out of the region to China.

The analysis shows that bilateral and trilateral agreements prevail over six-sided talks in the relations between Central Asia on the one hand, and China and Russia, on the other. The states' desire

83 Zhiqun Zhu, “China's New Diplomacy: Rationale, Strategies and Significance,” Ashgate, Farnham, 2010, 111–112.

84 Secretariat of the Shanghai Cooperation Organization, *Chronicle of Main Events at SCO in 2007* (Beijing: Shanghai Cooperation Organization, 2007), <http://www.sectsc.org/EN123/show.asp?id=97>.

85 Secretariat of the Shanghai Cooperation Organization, *Chronicle of Main Events at SCO in 2007*.

86 “State Agency for Management and Use of Hydrocarbon Resources under the President of Turkmenistan,” *Ministry of Oil and Gas Industry and Mineral Resources Journal*, n.d. <http://www.oilgas.gov.tm/minagenstvo.html>.

87 Kemal Toktomushev, “Central Asia and the Silk Road Economic Belt,” *Policy Brief*, 2016, <http://www.ucentralasia.org/Content/Downloads/Central%20Asia%20and%20the%20Silk%20Road%20Economic%20Belt.pdf>.

88 Getty Paul Stronski, “Turkmenistan at Twenty-Five: The High Price of Authoritarianism,” January 30, 2017, <http://carnegieendowment.org/2017/01/30/turkmenistan-at-twenty-five-high-price-of-authoritarianism-pub-67839>.

89 Shanghai Cooperation Organization, *Bishkek Declaration of the Heads of the Member States of the Shanghai Cooperation Organization* (2007).

to keep the bilateral format of interaction is not a problem, unless there are actors who wish to change it, but cannot due to an asymmetry in power. The extent to which a set of bilateral arrangements can represent an effective regional mechanism is questionable. Unless member states agree upon unified position over energy security and energy policy priorities, it will be quite difficult to integrate energy sectors within either of the initiatives, EAEU or SREB.

3.5 Strategic Importance of the Regional Energy Projects for China

The researchers from the Oxford University's Said Business School highlighted that China may not be always delivering high quality and efficient projects both inside China and abroad. Quite a number of projects, both domestic and foreign, suffer from poor management, cost overruns and lack of benefits. The geopolitical nature of economic projects causes such problems. An attempt to gain political leverage by building faulty power plants in Botswana is one of the examples. The strategy of providing cheap loans secures China's access to new markets with a high risk of debt default for these countries, but undermines its ability to recoup investments.⁹⁰

During the visit of the Chinese leader Xi Jinping to Turkmenistan, Kazakhstan, Uzbekistan and Kyrgyzstan from 3–13 September, 2013, investment and loan agreements worth US\$ 48 bln were signed, of which Kazakhstan will receive US\$ 30 bln, Uzbekistan will receive US\$ 15 bln and Kyrgyzstan will receive US\$ 3 bln.⁹¹ Most of these funds will be allocated to regional energy projects designed to secure supplies of Central Asian resources to China.

There are tensions regarding the implementation of some local projects. Over 22% of the foreign loans to Kyrgyzstan are spent to the development of its energy sector. Taking into account the fact that

some of the projects are not linked to the sources of finance, China's capability to return investments can be quite challenging.⁹² There are, for instance, already tensions between local Kyrgyz authorities and Chinese investors. An oil refining facility built by Chinese is only running on half of its capacity and the end-consumers receive even less products than before. While Kyrgyz officials are blaming the Chinese counterparts, in one of the interviews the refinery's director Andrei Yu Shan Lin claimed that: "We have an agreement to supply local [Kyrgyz] companies. How they distribute what we sell is not something we have knowledge of."⁹³

90 Spencer Sheehan, "The Problem with China's One Belt, One Road Strategy," *The Diplomat*, May 24, 2017, <http://thediplomat.com/2017/05/the-problem-with-chinas-one-belt-one-road-strategy/>.

91 Timuri Yakobashvili, "A Chinese Marshall Plan for Central Asia?" *CACI Analyst*, October 2013, <http://cacianalyst.org/publications/analytical-articles/item/12838-a-chinese-marshall-plan-for-central-asia?.html>.

92 Marat Musuraliev, "Problems in the Electro-energy Sector of Kyrgyzstan: Is There a Way Out?" April 22, 2016, <http://cabar.asia/en/marat-musuraliev-problems-in-the-electro-energy-sector-of-kyrgyzstan-is-there-a-way-out/>.

93 Chris Rickleton, "Central Asia Rues Dependency On Russian Fuel," *Eurasianet*, October 6, 2014, <http://www.eurasianet.org/>.

Conclusion

The report clearly illustrates that the two largest integration initiatives in the region are both complementary and competing depending on the nature and particular area of collaboration between China, Russia and the Central Asian states. The EAEU and the SREB both directly and indirectly pull Central Asian countries together and bind them to the greater powers' will to promote connectivity on the Eurasian continent. Yet, the analysis shows that a real regional component is missing within these integration initiatives. Without a well-functioning regional mechanism, which is also enabling member states to address sensitive issues, sustainable relations within the EAEU and the SREB can easily be compromised.

There is an overall asymmetry both in the relative amount of mutual trade and in the structure of mutual exports and imports within the EAEU and the SREB. While mineral and energy resources constitute the largest share of the export of the EAEU member states, imported are mainly machinery and textiles from China. Economic cooperation in general and trading dynamics in particular are highly dependent on the access to extensive and effective transport infrastructure. Russia is promoting trade with the Central Asian region by using existing road and railroad infrastructure backed up by a customs-free regime. And China, in turn, is heavily investing in building new transport infrastructure to get access to the European markets and connect its western regions to Central Asia. Despite the fact that transport infrastructure is being prioritized by China and Russia, the Central Asian region to a large extent remains periphery for them. For Russia, Central Asian markets are only a fraction of the EAEU economic space. And only 1 percent of China's export passes through land routes, including the Central Asian region.

In fact, economic integration goes beyond just physical connectivity and transportation networks. It also implies development of common industrial capacities by providing joint innovative industrial facilities, including the Eurasian network of technology transfer, technology platforms, clusters and engineering centers. The process of

establishing the above-mentioned platforms, however, is progressing rather slowly. Moreover, the development of industrial sectors in each of the participating state does not imply the evolvement of a comprehensive regional mechanism. Thus, the countries can hardly achieve real economic integration.

Even though energy sector cooperation is often being rated as strategic both within the EAEU and SREB, the analysis highlighted that energy relationships face even greater challenges, when it comes to establishing a regional platform and regulatory mechanisms. While the EAEU only has a nominal institutional apparatus, the SREB initiative is just a program the activity of which is based on bilateral agreements.

Most importantly, these regional initiatives so far failed to establish common energy markets. Participating member states do enjoy preferential conditions for energy export-import within the EAEU and the SREB, but without common energy markets sustainability of energy relations cannot be established. Largely bilateral formats of negotiations for transboundary energy networks and energy export-import relations prevent actors from developing a regional energy governance mechanism and share a common position over a few sensitive energy issues.

However, if further strengthened, the institutional apparatus of the EAEU may complement the activity of the SREB, which is so far based on bilateral agreements within the program. Also, in case the two initiatives are merged Central Asian countries may take advantage of, to some extent, using the institutional mechanism of the EAEU to also pursue ambitious goals within the Chinese initiative. To achieve this, any action taken within the initiatives must consider the interests of all participating states simultaneously, which can potentially be achieved through an effective Central Asian multi-lateral governance mechanism.

About the authors

Anna Gussarova, CAISS Co-founder and Director, expert in transnational security.

Farkhod Aminjonov, CAISS Co-founder and Deputy Director, expert in energy security.

Yevgeniy Khon, CAISS Deputy Director, expert in international political economy.

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