U.S.–CHINA RELATIONS
VOLUME I

CHINA, THE UNITED STATES, AND THE FUTURE OF CENTRAL ASIA

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PREFACE AND ACKNOWLEDGMENTS

There is already a vast and growing literature on U.S.-China relations. Starting with the Qing Dynasty (1644–1912) and continuing through the Chinese civil war (1934–49) and on to the present, there is a voluminous record of the interaction between Americans and Chinese. Not surprisingly, most of the work deals with bilateral ties: economic, cultural, diplomatic, and military.

The most significant change in this relationship has occurred in the past three decades as China changed from an isolated, low-income country to a major military power with the world's second-largest economy. Although China and the United States are economically interdependent, their differences in culture, political system, and history continue to make their interaction complex and often problematic.

One of the major goals of the New York University Center on U.S.-China Relations is to analyze the current interaction between the two states with the intent of identifying likely future trends. The center is sponsoring research on the linkages between Chinese and American capital markets and the differences between Beijing's and Washington's diplomatic styles.

In our center's research, we found one topic that has received only limited analytical attention: how do the United States and China interact in "third regions" where neither is dominant? This issue is significant because the United States is currently the world's sole superpower and the only country that has major interests in every continent on the globe. It is not clear yet whether China will choose to project its military power beyond Asia, but Beijing has already established its economic profile in Africa, the Middle East, Europe, and Latin America. Moreover, in selected areas where China's leaders see American policy as contrary to their interests, Beijing has been willing to thwart initiatives from Washington. Sudan, Syria, and Libya are examples where

China chose to directly constrain U.S. policy, while North Korea poses a complex case where there have been instances of both cooperation and resistance from Beijing.

It is reasonable to assume that China's influence and global presence will grow over time. Thus, the number of areas where the United States and China operate in proximity to each other will also increase. Hence, it would be useful to see whether we can ascertain consistent patterns in the interaction between the United States and China or whether the nature of the interaction varies considerably, depending upon the region involved.

If there is a great deal of consistency in Sino-U.S. relations in third regions, then precedent and predictability in policy formation become very important. If, however, we find considerable variation in the character and intensity of the relations, then policies can be more ad hoc and designed to fit regional circumstances rather than part of a set, global pattern. To explore the actual situation in distinct third regions, the New York University Center on U.S.-China Relations has decided to concentrate on three cases: Central Asia, Southeast Asia, and Latin America, and to do a separate volume on each. This volume on Central Asia is the first in this series.

* * *

An edited volume requires the effort and cooperation of many individuals. We were fortunate to have a superb group of chapter writers who, first, discussed our topic at the initial conference and, then, revised drafts as comments and suggestions developed. Thanks to all of them for their insight and patience as we proceeded.

There were also many others who helped as the volume progressed. Richard Solomon, J. Stapleton Roy, and Jerome Cohen all provided useful guidance as the book was planned. Subsequently, Nicholas Platt, Donald Zagoria, Donald Rice, James Hsiung, and M. I. Nadiri all made important comments. In addition, Winston Lord and Alexander Cooley read selective chapters and made many useful suggestions, as did two anonymous reviewers.

Also, New York University was supportive of the project and I got many helpful leads from Deans Thomas Carew and Michael Laver.

Moreover, throughout the process, Ms. Dongbo Wang was gracious and skillful at keeping the assorted aspects of the book on track. Finally, I want to thank Mr. Wenliang Wang for his encouragement and generous support, and NYU Press for its careful editing of the volume.

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Introduction

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Alternative Views of Central Asia's Future

DAVID B. H. DENOON

Overview

The collapse of the Soviet Union in 1991 led to the creation of five newly independent states in Central Asia: Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Each of these states had been conquered by imperial Russia and subsequently was tightly controlled by the Union of Soviet Socialist Republics. The process of establishing themselves as truly autonomous states has been the central enterprise for these five countries in the last twenty-two years.

The demise of the USSR also led to dramatic changes in the global strategic environment: the Warsaw Pact unraveled, the Soviet Union itself splintered into numerous states, and the Cold War ended. Most of the Western commentary on these developments focused on the reduced military threat and the independence of Belarus, Ukraine, and the states in the Caucasus. Few Westerners knew much about Central Asia, and even fewer followed the halting steps of the Central Asian states toward greater economic and political autonomy.

Only after September 11, 2001, when the United States began to use Central Asia as a transit route to Afghanistan, did greater numbers of Americans learn about air bases and truck routes in Central Asia. Also, it was only then that Americans became more aware of Islamist networks spreading from the Middle East and Afghanistan into Central Asia.

Roughly simultaneously with the rise of Islamist groups came the rise of China. These two seemingly unrelated historical developments combined together and provided a new platform for the interplay of the United States and China in Central Asia.

Though the 1990s were relatively tranquil in military terms, the first decade of the twenty-first century was a veritable cauldron of turmoil, as the world adjusted to surging Islamist and Chinese capabilities.

So why is it useful to have a volume that links the United States and China and Central Asia?

First, China is the only *state* that has the potential to directly challenge American global leadership.

Second, militant Islamist movements are the only *nonstate groups* that are openly confronting American and Western institutions, and they thrive in Central Asia.

Finally, Central Asia is important in its own right because it is the vital fulcrum between the dynamism of East Asia and the wealth and technology in Western Europe.

What we do below is briefly survey the literature on bilateral relations between the United States and China, and then, by concentrating on Sino-American relations *inside Central Asia*, we will show what is distinctive about this volume.

The rise of China has led to a massive outpouring of commentary and analysis. In the past three years alone, there have been at least six major studies dealing with bilateral relations between the United States and China.[1]

There are many useful perspectives in this literature. Some have emphasized the historical interaction between China and the West, noting that the nineteenth and early twentieth centuries were periods when China was on the defensive and under pressure from outsiders.[2] Others, like earlier studies, have stressed the cultural aspects of the sparring between China and the West and the difficulties each side faced in coping with the other.[3]

Also, during the past two decades, as China's growth stunned outside observers, much of the discussion between Beijing and Washington has been over trading regimes and how to adjust to China becoming the world's largest manufactured-goods exporter.[4]

In addition, of course, the rapid growth of China's military capability and Beijing's new assertiveness on territorial and maritime claims issues with its neighbors have led to major debates about China's intentions.[5]

Yet what is notable about Central Asia, in the past two decades, is that China and the United States, despite their problems elsewhere, have pursued different objectives in the region and not had any direct clash of interests.

Some of the most significant problems in Central Asia have been developmental ones for the five states. Moving away from centrally planned economies has been resisted by the political elites, who were all trained in Soviet-style management. Private sector business in Central Asia has been mostly small firms or an occasional quasi-public company where a well-connected person got control of a former state enterprise. Since the political elite has little incentive to privatize the remaining large companies, there has been an ongoing standoff between outside donors and advisors (who favor privatization) and most of the current elite.[6] Also, it is clear that the political leaders can extract resources from these state enterprises on a predictable basis, whereas a truly independent private sector would resist side payments and even be an alternative source of power.[7]

Creating real autonomy for the five Central Asian states has also faced serious obstacles. Russia has waxed and waned in its interest in Central Asia since 1991. President Yeltsin wanted to concentrate on internal Russian issues, but President Putin has consistently had a strong concern with the "near abroad." When the Commonwealth of Independent States concept failed to gain support, Putin then suggested a series of organizations to cement political, economic, and security ties with Central Asia. Moscow proposed and successfully persuaded certain Central Asian states to join the Collective Security Treaty Organization (CSTO), the Eurasian Economic Community (EurAsEC), and the Customs Union Commission (CUC).[8]

Both the United States and China have made major overtures to Central Asia as well. The United States put effort into encouraging economic integration *among* the Central Asian countries, but when that foundered on friction between Kazakhstan and Uzbekistan, Washington has stressed bilateral efforts at economic assistance and defense cooperation.[9]

China's programs in Central Asia have been predominantly economic, though its signature effort, the Shanghai Cooperation Organization (which includes four Central Asian states plus Russia as members) has recently begun to discuss security issues, notably Islamic militancy.[10]

In addition, each of the Central Asian states has ethnic divisions that make creating a unified state difficult.[11] These ethnic differences are particularly prominent in Kyrgyzstan and Uzbekistan. These long-standing frictions are now exacerbated by the rise of militant Islam and have led to outbreaks of violence and government crackdowns in Kazakhstan, Kyrgyzstan, and Uzbekistan.[12]

Major Themes of This Volume

1. China and the United States are not currently in conflict or experiencing direct friction in Central Asia because they have different objectives and interests. Washington's principal concerns are military and relate to supplying U.S. and NATO troops in Afghanistan. The major concerns of the Chinese are economic and relate mostly to ensuring access to oil and gas supplies in Kazakhstan and Turkmenistan. Beijing's major military worry in Central Asia is Islamic protest and organization directed at Xinjiang. In this latter regard, America and China are aligned in the desire to limit the spread of militant Islam.
2. If there is any power that is competing with the United States for strategic influence in Central Asia, it is Russia. Key members of the Russian leadership want to reassert Moscow's influence in Central Asia, and they see the post-2001 role of the United States in Tajikistan and Kyrgyzstan especially as inimical to Russian interests.
3. Since it is unclear whether the United States will try to maintain a presence in Central Asia after the NATO withdrawal from Afghanistan in 2014, the less powerful states on the periphery of Central Asia are waiting for an opportunity to increase their influence. India, Pakistan, Iran, and Turkey each have some ambitions in Central Asia and are maneuvering to test out what roles they can play.
4. Thus, we are in a waiting period, during which the Central Asian states themselves are pursuing their respective policies to ensure their autonomy, while the outside powers are calculating how to position themselves for the changing strategic environment in Central Asia.

We will return to each of these themes in the balance of this chapter and in the body of this volume as different authors examine Central Asian developments in depth.

Why Is Central Asia Significant by Itself?

In the nineteenth century, Central Asia was the region of the "Great Game"—the ongoing contest between the British, from their base in India, and imperial Russia, from its contiguous territory.[13] This British-Russian competition was significant then not only because of the resources expended but because leaders in St. Petersburg and London saw this as part of a global balancing effort. Britain's influence was rising, while Russia's was gradually declining, and the contest was capped by Russia's humiliating naval defeat by Japan in 1905.

Ironically, after World War I, although imperial Russia had collapsed, the Soviet Union was able to re-infuse itself into Central Asia and fully incorporate Central Asia as five provinces of the USSR. By the start of World War II, one of Germany's central goals was to expand southeast into the Caucasus and east into Ukraine and Central Asia to gain control of the farmland and hydrocarbons there.

Thus, we see major strategic choices that were made between 1850 and 1945 playing themselves out in Central Asia or its periphery. Britain's naval power was a key inspiration for A. T. Mahan's book *The Influence of Sea Power upon History*, whereas Harold Mackinder and Nicholas Spykman stressed the importance of controlling land and the Eurasian heartland as a pivot point between Europe and Asia.[14] Yet it was the combination of land and naval power in Britain's favor that explained the shift in global balances of that period. Although the Nazi-Soviet Pact of 1939 briefly gave Germany potential access to oil in the Caucasus, once Hitler and Stalin were at war, the Eurasian heartland became a key objective for German attacks.

The tenacity of the USSR during World War II meant that Germany never succeeded in controlling the Caucasus and Central Asia, and Moscow was able to preserve its dominance there until 1991. However, as Zbigniew Brzezinski notes, "two aspirants to global power, Adolf Hitler and Joseph Stalin, explicitly agreed that America should be excluded from Eurasia. Each realized that the injection of American power into Eurasia would preclude his ambitions regarding global domination."[15] We see a somewhat analogous situation today, where neither Russia nor China wants the United States to stay in Central Asia after NATO's departure from Afghanistan.

Obviously Eurasia is a wider area than Central Asia, and it now includes China and Japan as well as Europe. Nevertheless, Central Asia is the linchpin between Asia and Europe. Thus, keeping Central Asia autonomous is vital to preventing any one power gaining dominance in Eurasia.

Thus, Central Asia's first critical feature is its location.

Central Asia's second vital asset is its hydrocarbon resources. Kazakhstan has 30 billion barrels of oil reserves. Although this is only one-eighth of the proven reserves in Saudi Arabia, it is worth roughly $2.5 trillion at current world prices, after expenses for extraction. This is, clearly, enough to create a sizable annual annuity for each Kazakh.

At a similar level of importance is Turkmenistan's natural gas, estimated at 265 trillion cubic feet.[16] Turkmenistan's gas reserves put it in the world's top five potential producers. It is also worth noting that Kazakhstan's and Turkmenistan's abundance of resources is in contrast to the relative paucity of hydrocarbons in the other three Central Asian states.

Central Asia's third distinctive feature is not an asset. It is a dilemma: movements that seek to establish Islamist governments.[17] These movements grow out of religious fervor and assorted grievances and have led to underground activities and violent protests in Kazakhstan, Kyrgyzstan, and Uzbekistan. In addition, Tajikistan had what amounted to a civil war in the early and mid-1990s.[18]

So Central Asia has key advantages in its location and natural resources, but is a tinderbox where political instability could surface at any time. Also, because Central Asia borders on Afghanistan and Pakistan, there is no question that instability could stem from inside Central Asia leading out or the reverse.[19]

The biggest uncertainty facing Central Asia is what will happen when Western forces leave Afghanistan. The major powers (the United States, China, and Russia) realize that they cannot control Central Asia as do the regional powers on its periphery. At present, the object of all these states is to gain influence and prevent any single other power from gaining a dominant position. Before turning to the roles of the outside powers, we will provide more background on the trends inside the Central Asian states.

Inside Central Asia: Four Major Processes Under Way

Since 1991, establishing autonomy and new identities separate from Russia has been the key objective of all the Central Asian states. Russian imperial and Soviet domination of Central Asia created a very complex interaction between the capital and its dependencies. Central Asian elites took Russian names, were educated in Moscow, and created a myriad of business and personal relationships.[20]

Yet a strong desire to be independent and to chart its own course led each Central Asian state to choose a slightly different path. Kazakhstan, with its vast oil reserves, has been the most confident about its bargaining power with Moscow and thus often willing to collaborate closely with its former colonial ruler. At the other extreme is Turkmenistan, which has chosen a starkly isolationist path. Kyrgyzstan, with its small size and concerns about being coerced by its Central Asian neighbors and China, has often openly sided with Moscow.[21] Tajikistan has been willing to tolerate Russian troops on its soil, due to its perilous internal security situation, while Uzbekistan has shifted back and forth between support for and vehement opposition to Russian influence.[22]

Reconfiguring Their Economic Development Strategies

When they were part of the Russian Empire or the Soviet Union, the Central Asian states were essentially agricultural and raw material suppliers for their overlords. Kazakhstan was notable for its cotton and oil, while Uzbekistan's Ferghana Valley was a fertile source of many fruits and grain crops. The situation today is now far more diverse.[23] Kazakhstan has leveraged its hydrocarbon resources to launch a range of industries; Turkmenistan is in the process of developing gas-related projects; Tajikistan is broadening its agricultural base; Kyrgyzstan has become an entrepôt between China and Central Asia; and Uzbekistan is promoting itself as the central state for communications and transportation with the Central Asian region.[24]

The Central Asian states question whether they can build steadily on their efforts toward greater economic diversity. As mentioned, most of the early leadership in post-1991 Central Asia had been trained in

Moscow and favored centrally led economies for a variety of reasons. Direction from the center made political control and patronage easier, facilitated the extraction of resources from enterprises, and kept opponents marginalized. The problem is that it is generally inefficient. Hence, Western economists have usually recommended partial or full privatization and linking states with the world trading system as a means for encouraging efficiency.[25] Yet political control and gaining economic advantages for leaders have generally gotten top priority in Central Asia. This means that economic modernization has often been a secondary objective.[26]

Dealing with Internal Unrest, Separatism, and Islamist Groups

As noted above, Islamist and separatist groups have become increasingly able to challenge established governments in Central Asia.[27] Except for Kyrgyzstan, which has alternated between riots and voting as a means to change leadership, the Central Asian states have had authoritarian rulers throughout their post-1991 independence period. Kazakh president Nursultan Nazarbaev and Uzbek president Islam Karimov ascended directly to power from their positions as Soviet party leaders and have brooked no opposition since. President Emomali Rahmon of Tajikistan represents a similar form of secular, authoritarian leader. Ironically, only in Turkmenistan, which is the most isolated of the Central Asian states, has there been a peaceful transition of power since 1991; when President Saparmurat Niyazov died in 2006, Gurbanguly Berdimuhamedov emerged, after private maneuvering, to claim the presidency. Berdimuhamedov has not been openly challenged since.

Thus, in four of the five states of Central Asia we have a general pattern: authoritarian, secular leaders run societies that are overwhelmingly Muslim. This creates an inherent tension between the values of the public and those of the leadership. In those cases where there is radical Islamic organizational ability that the governments cannot completely suppress, periodic uprisings occur.[28] In the one democratic state, Kyrgyzstan, there is more freedom of expression but a deep ethnic split between the Kyrgyz majority and Uzbek minority.

Hence, it is reasonable to surmise that Central Asia has more political instability ahead. Presidents Nazarbaev and Karimov are in their seventies, so future aspirants to power will be positioning themselves; and throughout the region, the rise of militant Islam will challenge secular governments. There have not yet been general uprisings in Central Asia like the "Arab Spring" revolts of 2011–2012, but they cannot be ruled out as a possibility.

Determining How to Deal with Regional Powers on Their Periphery

Below we will analyze in greater detail how the Central Asian states deal with the major powers, but it is first worth noting that the "regional powers" on their periphery pose both risks and opportunities. At various times in the past two decades, both Iran and Turkey have made efforts to expand contacts and influence in Central Asia.[29] Neither of these has been particularly successful recently, but there are strong cultural and ethnic ties as well. Many of the languages in Central Asia are Turkic in origin, whereas Tajik is based on Persian. This, plus the different models of Islam that Turkey and Iran represent, also provides inspiration for links to the region's middle powers.[30]

The regional power with the most intent and capability to affect Central Asia is India.[31] Strategists in New Delhi have two major objectives in Central Asia: gaining access to the hydrocarbons and preventing Pakistan from forming a broad Islamic coalition against India.

Obtaining Central Asian oil and gas would reduce India's dependence on Iran and the Middle East; thus the appeal of the proposed Turkmenistan—Afghan—Pakistan—India (TAPI) pipeline. The problem is that no company will build the TAPI line without a secure peace in Afghanistan and improved relations between Pakistan and India. However, even if the TAPI pipeline is not built, India would still like to have good relations with Central Asia so that it is not facing united northern Islamic antagonism.[32] India has therefore put substantial resources into aid for Afghanistan, offers various aid programs to Central Asian states, and has achieved observer status in the Shanghai Cooperation Organization. This has not yet yielded close ties in

Central Asia, but its minimum objective has been achieved as India does not find itself excluded from the region.

The Outside Major Powers: Russia, the United States, and China

Russia's long-term involvement in Central Asia has created both opportunities and drawbacks for its current policies. As mentioned, the long-term involvement means that there are close personal contacts with most of the current leadership in Central Asia, ease of communication in Russian, and, in many cases, common approaches to issues.[33] On the other hand, in those situations where the Central Asian decision maker has had negative experiences dealing with Moscow, the historical legacy can be a hindrance to current relations.

After the demise of the Soviet Union, President Yeltsin took little interest in Central Asia, and many of the leaders there felt abandoned. President Putin has reversed that stance and placed significant emphasis on "Russia's near abroad," which includes Eastern and Southern Europe as well as Central Asia.[34]

The dilemma for the Central Asian states is that Putin's embrace often comes with a price: increased dependence on Russia.[35] Moscow has tried to prevent the Central Asian governments from signing pipeline deals that moved gas or oil without going through Russia. Moscow has also pressed the Central Asian states to cooperate in national security arrangements or in aligning with Russian positions on controversies that many in Central Asia found unacceptable. This has been particularly true regarding Russia's stance on Georgia and North Ossetia.[36]

Putin certainly recognizes that the United States will have trouble maintaining its influence in Central Asia after NATO's fighting units depart from Afghanistan, so many see his efforts as directed toward picking up the pieces after the thirteen-year American interregnum ends.

The United States faces serious intervention fatigue after its wars in Afghanistan and Iraq. At the start of these wars, few foreign affairs specialists and even fewer of the American public would have anticipated that U.S. troops would spend nine years in Iraq and almost a decade and a half in Afghanistan at a terrible human and financial cost. Thus, the public sentiment in the United States is strongly against further commitments of forces or aid in the Middle East and Central Asia. For example, this experience is surely inhibiting President Obama from making any large-scale commitments to intervene in Syria.

Nevertheless, the question remains: What role will the United States assume in Central Asia "after Afghanistan"?[37]

First of all, there may be several Central Asian states that want the United States as a balancer against growing Russian and Chinese influence. Uzbekistan and Kyrgyzstan are both states that see their neighbors as problematic and may want an outside friend, if not ally.[38] Tajikistan may fit in this category as well if Afghanistan devolves into a decentralized state with the Tajik "northern alliance" seeking protection from the Pushtun majority in the south.

Also, there may be purely pragmatic regimes that see financial benefits from allowing American use of their roads, rails, or airports.[39] This may have already played a part in the cooperation with the U.S. Northern Distribution Network (NDN), which channels supplies through Central Asia to Afghanistan.

Moreover, even though Turkmenistan has been strictly neutral and isolationist, it has chosen to let China be a major developer of its gas reserves. This has been a source of irritation to Russia but an indication that policy makers in Ashgabat see merit in diversifying their potential supporters. The effort to countervail the influence of Russia with China might even motivate Turkmenistan to see the benefit of ties with the United States.[40]

Nevertheless, the current gridlock in Washington and inability to agree in the Congress on broad goals for foreign policy make it unlikely that there will be American support for an interventionist and broad-gauged role in Central Asia. That means that policy makers in Washington may end up focusing on narrower goals, such as countering Islamic militant groups and maintaining sufficiently good relations with some Central Asian states so that U.S. forces can gain access in critical situations. Yet the more ambitious objectives of promoting democracy and transparent government (which characterized American policy in the 1990s) seem unattainable and a relic of the past.

Clearly, the most enigmatic outside power today in Central Asia is China. Although official Chinese policy emphasizes the importance of Central Asia, Beijing is actually keeping a very limited profile. China has become the world's second-largest oil importer at 5.5 million barrels a day in 2011. Only about 5 percent of that oil comes from Central Asia (Kazakhstan), but once the Turkmenistan gas is flowing at full capacity, Central Asia may be supplying a sizable percentage of China's hydrocarbon imports. This is critical to Beijing's overall energy security plans because Central Asian imports come directly to China and are not subject to interdiction in the Persian Gulf, in the Indian Ocean, or in Southeast Asia. Thus, it is understandable that Beijing wants to pursue a low-keyed approach to energy acquisition that keeps China out of the limelight.

Yet China's broader objectives, of shaping developments in neighboring states, limiting the spread of Islamic fundamentalism into Xinjiang Province, and balancing Russia's influence in Central Asia, cannot be achieved with its current low-profile stance.[41] There are ample indications that China is confident about balancing Russia and working with Moscow to limit the influence of the United States and Europe in Central Asia. The question of how to deal with Islamic fundamentalism poses a more complex challenge.

At present, China is content to have the United States take the lead in dealing with Muslim terrorists.[42] China has enough problems with its own Uighurs (mostly in Xinjiang) that it does not want to antagonize Muslims in Central Asia who could be a source of training and financial support for dissidents inside China.

Also, China has worked diligently to keep good relations with both Sunnis and Shias in the Muslim world. Beijing needs Iranian oil, so has been unwilling to take a stance against the Assad regime in Syria, which is aligned with Tehran. Moreover, ties with Shia states give China acceptable relations with Hezbollah in Lebanon and Gaza as well.

Nevertheless, China's most important relations in the Muslim world are with the Sunni regimes in Saudi Arabia and Pakistan. Saudi Arabia is China's largest supplier of imported oil, as it provides almost twice the annual amount supplied by Iran. Also, given Saudi Arabia's role in the Sunni community, China is careful not to antagonize Riyadh's partners as well.

Yet Pakistan is even more critical to China because of Islamabad's role in balancing India. Pakistan's presence preoccupies India and keeps New Delhi facing northwest, not northeast toward China.[43] Since 1998, when Pakistan successfully tested nuclear weapons, India has been thwarted in its ability to coerce Pakistan, and that frees China to focus on its expanded relations with Bangladesh, Sri Lanka, and Myanmar, all littoral states on the Bay of Bengal. Although Beijing and New Delhi have cordial relations for public consumption, leaders in both states know that each represents the main regional rival to the other.

At the broadest strategic level, China's principal foreign policy concern remains the United States.[44] Beijing has not yet revealed to the world how active its long-term foreign policy will be. At present China is satisfied to play a relatively low-keyed role in Central Asia, to balance its relations between Sunni and Shia states in the Middle East, and to expand its ties with the states surrounding India. All of these moves will give Beijing options in the future, but China cannot please all of these states indefinitely. If there is greater turmoil in Central and South Asia when U.S. and NATO forces leave Afghanistan, China will need to decide whether it is willing to intervene to play a stabilizing role. Otherwise, China will need to cede the role of aspiring outside powers to Iran, India, Pakistan, and Russia, each of which has shown interest in greater influence in Central Asia.

In the subsequent chapters of this volume, each of the authors will examine aspects of Central Asia's development from their particular perspective. Then, in the concluding chapter, the editor will summarize the basic findings and evaluate the extent to which common themes are found in all the chapters.

Organization of the Volume

The "Overview" section of the book provides the basic rationale for the volume and a survey of the principal economic and foreign policy issues facing Central Asia. The chapter by Nazgul Jenish highlights the very significant differences in resource endowment and levels of development within Central Asia. The chapter also demonstrates that Central Asian governments and their state-owned enterprises frequently misallocate funds and divert resources to private uses. This pattern of closely held, self-aggrandizing actions is evident, as well, in Marlene Laruelle's analysis of the foreign policies of the Central Asian states.

In the section entitled "Outside Powers," each of the authors comments on the notable success of the Central Asian states in establishing their autonomy after independence in 1991. Although Russia is deeply ambivalent about this Central Asian autonomy, China, the United States, and the European Union each have their own reasons to encourage it. In addition, Japan, India, and Turkey would each like more influence in Central Asia, but do not yet have the right circumstances to move from being marginal to major players there.

In the "Regional Integration" section, the authors identify the reasons why Central Asian economic ties are more with outside states than within the region. As Richard Pomfret illustrates, all of the Central Asian states are natural resource or agricultural exporters, and manufacturing is still limited within the region. Also, since the major wealth in Central Asia is in oil in Kazakhstan and natural gas in Turkmenistan, there is no simple process to encourage enhanced intra-regional trade. Finally, as Pan Guang notes, the Shanghai Cooperation Organization (SCO) has the potential to encourage regional integration, but its efforts to date have been more political than economic.

The concluding chapter identifies areas of consensus and difference among the volume's authors. In addition, it comments on the likely impact of the U.S. withdrawal from Afghanistan and growing efforts at cooperation between China and Russia.

NOTES

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2

Walls and Windmills

Economic Development in Central Asia

NAZGUL JENISH

When the wind changes direction, there are those who build walls and those who build windmills.
—Old Chinese proverb

Introduction

Nestled in the heart of the Eurasian continent, Central Asia[1] is a key geographic nexus between the world's most dynamic economies of China, India, and Russia. Within this nexus lies an intricate knot of geopolitical, economic, and security challenges and opportunities that may shape the future of the entire continent.

Since ancient times, Central Asia's location at the crossroads of Asia and Europe has largely determined its role and interaction with the rest of the world. From early antiquity to the High Middle Ages, Central Asia was a land of nomadic tribes that generated waves of massive human migration sweeping across Asia and Europe: the Scythians and Sarmatians (eighth to third centuries BC), the Huns (third to fourth centuries AD), the Turks (sixth to eleventh centuries AD), and the Mongols (twelfth to thirteenth centuries AD). After its unification under the Mongol Empire, this epicenter of human tsunami turned into a major transit center for the flow of goods between China and Europe. Traversing Central Asia east to west, the Silk Road served as the land bridge connecting China with Europe. The trade on the Silk Road waned with the disintegration of the Mongol Empire in the fourteenth century. The spin-offs of the Mongol Empire in Central Asia—Bukhara, Khiva, and Kokand Khanates—became a buffer zone between the Russian and

British Empires in the nineteenth century. They were subsequently conquered by the Russian Empire. This period is widely known as the "Great Game"—geopolitical rivalry of the Russian and British Empires for supremacy in the region.

The collapse of the Soviet Union in 1991 turned a new page in the history of Central Asia, and brought it again to the forefront of international attention. But this time, in addition to its geostrategic salience, Central Asia has assumed considerable economic importance due to its fabulous mineral wealth. The region is endowed with abundant reserves of oil, natural gas, gold, aluminum, uranium, and rare earth metals. Given the rising demand for hydrocarbons and instability in the Middle East, China and Europe are turning more and more to Central Asia to secure and diversify their hydrocarbon supplies. Moreover, Central Asia's geostrategic and security relevance has become even more pronounced with the establishment of a network of U.S. and NATO bases on its territory as well as the launching of the Northern Distribution Network, a vital supply route supporting the war in Afghanistan.

Against this backdrop, sustained socioeconomic development and stability in the region are key to the political and economic security of the Eurasian continent. This chapter examines recent developments in the socioeconomic situation in the five Central Asian states of the former Soviet Union, with a particular focus on the relations of these countries with China. The main issues addressed are (1) whether the hitherto rapid economic growth in the region will persist into the future; (2) the challenges and opportunities for the region's development, and the role of China in this process; and (3) the potential for the economic integration of Central Asia.

Our answer to the first question is largely negative. Structurally, the Central Asian economies have seen a lopsided development of a few commodity-exporting sectors, and the high growth rates have mainly been driven by surging demand and prices in these sectors. In contrast, the share of higher-value-added, capital- and technology-intensive industries remains very modest; the hefty natural resource rents have not brought an industrial revival to the region. Furthermore, the region is cursed with one of the most prohibitive transportation costs in the world due to its landlocked location. The cost of exporting for Central Asia is six times that for China and Vietnam, and more than twice that for Southeastern European countries.[2] Thus, the highly skewed structure of the Central Asian economies and high transportation costs jeopardize their medium- and long-run growth prospects. In the short run, the region's growth is likely to be moderate, reflecting the slackening commodity demand and general economic slowdown in the world. In particular, Kazakhstan's GDP growth decelerated from 7.5 percent in 2011 to 5.8 percent in 2012, and was expected to remain around 5 percent in 2013 and 2014. Growth in Turkmenistan was forecast to slow after 2012.[3]

Moreover, poor governance, pervasive corruption, and rising social tensions pose a serious threat to sustained socioeconomic development in the region. In particular, the governance situation is deplorable, and corruption is rampant. The global financial crisis has further intensified social polarization in the region. The public funding of education and health care is low compared to other transition economies, despite the substantial natural resource rents. Some selected socioeconomic indicators for the Central Asian countries are summarized in table 2.4 in the appendix.

At the same time, the Central Asian countries have made considerable progress in integrating into the world economy. Both economically and politically, they have pursued a "multi-vector" strategy of engaging with all significant international players to balance the influence of their big neighbors. Nowhere has the "multi-vector" strategy of the Central Asian states manifested itself so graphically as in their oil and gas policy, with new pipelines built in all directions. However, the direction of the resultant vector has recently shifted to the east, with China outflanking Russia and Europe as the largest market for Central Asian hydrocarbons. This shift in the regional energy vector may tilt the overall geopolitical center of gravity in the same direction.

While the Central Asian countries became more integrated into the global economy, they drifted more and more away from each other. The Central Asian countries seem to have been erecting walls between themselves with the same vigor as they have been building pipelines to harness winds of opportunity blowing from China. While the overall trade of the Central Asian countries has significantly expanded, the share of intra-regional trade in total trade has been continuously declining due to various protectionist measures, weak infrastructure, and customs and transit bottlenecks. Regional integration has also been hindered by territorial disputes and tensions over water and energy.

Economic Performance in 2000–2008

None of the five Central Asian countries endeavored independence, and they were very poorly prepared for it when it occurred. The collapse of the Soviet Union brought severe blows to these countries. First, the common ruble zone persisted until the fall of 1993, but without any monetary discipline whatsoever. As a consequence, the whole region was caught in hyperinflation in 1993, ranging from 885 percent in Uzbekistan to 9,750 percent in Turkmenistan.[4] Second, substantial Soviet budget subsidies of about one-tenth of GDP of each country ceased.[5] Third, the old Soviet trade system collapsed in the course of 1991–1994, while hardly any new trade could develop, since both the payments and trade systems lay in tatters. Trade and transportation were all the more difficult in this region, since all these countries are profoundly landlocked.

As a consequence, all the Central Asian countries faced horrendous declines in output. Kazakhstan, Kyrgyzstan, and Uzbekistan hit their nadirs in 1995, Tajikistan in 1996, and Turkmenistan only in 1997. The cumulative official declines in GDP from 1989 amounted to 19.5 percent in Uzbekistan, 35.8 percent in Turkmenistan, 39.2 percent in Kazakhstan, 46.9 percent in Kyrgyzstan, and 64.2 percent in Tajikistan.[6] These declines were exaggerated by poor measurement in the transition, but output declines were great.

A precondition for new economic growth everywhere was macroeconomic stabilization. Inflation had to fall to the double digits. Kazakhstan, Kyrgyzstan, and Tajikistan became market economies, while Turkmenistan and Uzbekistan largely restored their centralized state-run economies. The inconsistencies of economic systems greatly impeded revival of regional trade and economic integration.[7] The differences in output decline can, to a considerable extent, be explained by the terms of trade for their major exports. Uzbekistan was saved by high cotton prices in the 1990s, while Turkmenistan and Kazakhstan had plenty of natural gas and oil.[8] Kyrgyzstan and Tajikistan had no major exports, and Tajikistan was devastated by civil war in the early 1990s.

Economic Growth

After a decade of severe economic hardship following the collapse of the Soviet Union, the Central Asian states experienced an impressive economic growth in 2000–2008. Although from a low base, the growth averaged 9 percent per year, the highest for any region in the world. Rates of growth varied across the countries. The growth leaders were Turkmenistan and Kazakhstan, with average annual GDP growth rates of 14 percent and 9.5 percent, respectively, while the worst-performing was Kyrgyzstan, with an average growth of 5 percent (see figure 2.1). The sectorial contributions to growth are depicted in figures 2.13–2.17 in the appendix. This spectacular growth was propelled by a combination of three different factors, including high commodity prices, ample unutilized production capacity and human capital inherited from the Soviet Union, and market reforms and improved macroeconomic management. But this was most of all a commodity boom.

The high aggregate growth rates mask important country-level differences. The main distinction between the region's countries lies in their energy sectors. Three of the five countries—Kazakhstan, Turkmenistan, and Uzbekistan—are net exporters of oil and natural gas, while Kyrgyzstan and Tajikistan rely on hydrocarbon imports. This key

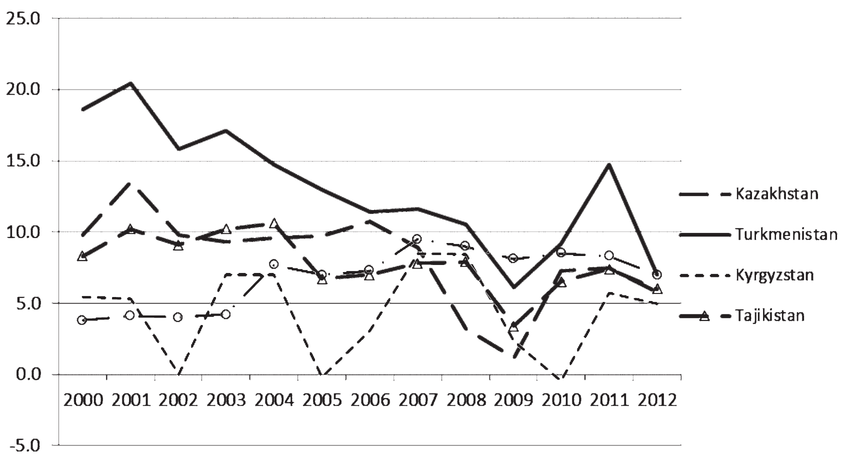

Figure 2.1. GDP growth rate (%). *Source*: International Monetary Fund, *World Economic Outlook*.

feature explains the differences in the pattern of economic development across the region. High oil and gas prices were the growth drivers in Kazakhstan, Turkmenistan, and, to a lesser extent, Uzbekistan, which began expanding its hydrocarbon exports relatively recently. In addition, Uzbekistan derives a sizeable share of its income from cotton and gold exports. The growth in Kyrgyzstan was led by gold production and the agricultural sector, while the growth in Tajikistan was associated with aluminum and cotton exports. These two countries together with Uzbekistan also benefitted from migrant worker remittances coming from Russia.[9]

Finally, market reforms and sound macroeconomic policies also contributed to the economic expansion of Kazakhstan, Kyrgyzstan, and Tajikistan. These countries had undertaken substantial market reforms and entered the new millennium with predominantly private ownership and reasonable macroeconomic stability. According to the EBRD (European Bank for Reconstruction and Development), their private sectors generated 65, 75, and 55 percent, respectively, of their GDP in 2010.[10] The private sector stagnated in Turkmenistan and Uzbekistan, at 25 and 45 percent of GDP, respectively, and they largely retained a Soviet economic system with a dominant state sector and omnipresent state regulation.

Trade and Industrial Performance

Following the sharp decline in the 1990s, trade expanded at a remarkable pace in all Central Asian states in 2000–2008 (see table 2.1). Exports grew on average by 11 percent a year. However, both the composition and geographic distribution of exports remain narrow. Exports were dominated by a few primary commodities (oil, natural gas, gold, aluminum, and cotton) and destined to a handful of countries. In 2008 the region's Herfindahl-Hirschman index (a widely used measure of product concentration ranging from 0 to 1, with 1 being the maximum concentration) stood at 0.5, compared to 0.08 for South and East European countries.[11] The main export markets for Central Asian commodities are China, Russia, Turkey, Italy, Switzerland, Netherlands, and France.

On the other hand, imports were mainly limited to machinery and equipment. The growth in this category was particularly sizeable in the

TABLE 2.1. Trade and Industrial Performance

Country	Average annual growth rate of exports (%) 2000–2008	Exports + imports as a share of GDP (%) 2008	Manufacturing value added per capita (constant 2000 US $) 2000	2008
Kazakhstan	8.3	94	203	337
Kyrgyzstan	6.9	147	50	52
Tajikistan	7.3	89	43	79
Turkmenistan	27.4[a]	116	63	n.a.
Uzbekistan	4.4[b]	85	46	50

Source: World Bank.
[a] Turkmenistan export growth rate for 2000–2006.
[b] Uzbekistan export growth rate for 2000–2005.

oil-producing countries, which made substantial capital investments in their mining sectors. Russia, China, Turkey, South Korea, and Germany are the main sources of Central Asian imports.

The rapid expansion of trade was mostly due to intensification of interregional trade, especially with China. The intra-regional trade among the Central Asian countries was much smaller, though it increased in absolute terms relative to the 1990s. The share of intra-regional exports in total exports declined from 8.4 percent in 1999 to 4.4 percent in 2010. This can only partially be explained by the low degree of trade complementarity between the Central Asian economies. Various tariff and nontariff barriers, including discriminatory taxes, restrictive sanitary norms, hostile custom and transit procedures, and outright border closures, have been more serious obstacles for intra-regional trade. The composition of intra-regional trade has been limited to energy, agricultural products, and apparel. The hydrocarbon importers are more dependent on intra-regional trade than their oil-exporting neighbors. For instance, Kyrgyzstan relies on imports of refined oil products and natural gas from Kazakhstan and Uzbekistan, and in turn sells agricultural products (meat, dairy) and apparel to these countries. Tajikistan imports crude oil and natural gas from Uzbekistan, and wheat from Kazakhstan.

Despite geographic proximity, the region did not trade much with South Asia, except Afghanistan. The main export commodities to

Afghanistan are refined oil products, electricity, and wheat. Exports to India have been negligible for all Central Asian countries except Uzbekistan (cotton, zinc) and Kazakhstan (uranium). Given the geographic proximity and complementarity in industrial output, there is a substantial unrealized trade potential between the Central and South Asian regions.

The volumes and composition of exports also illuminate the structure of the Central Asian economies, which are characterized by a strong specialization in mining and agriculture. Diversification and sophistication of production are generally recognized as the key drivers of middle- and low-income countries' competitiveness in the world market. The Central Asian countries, however, show little sign of economic diversification and sophistication, perhaps with the exception of Uzbekistan, which has recently expanded its noncommodity exports comprising machinery and chemicals.

The industrial structure in all countries but Uzbekistan had become even more lopsided in 2008 compared to 2000. The share of crude oil and oil products in Kazakh exports soared from 53 percent in 2000 to 69 percent in 2008 (see figure 2.2). Metals (iron, steel, and copper)—the second-largest export grouping after crude oil in Kazakhstan—can

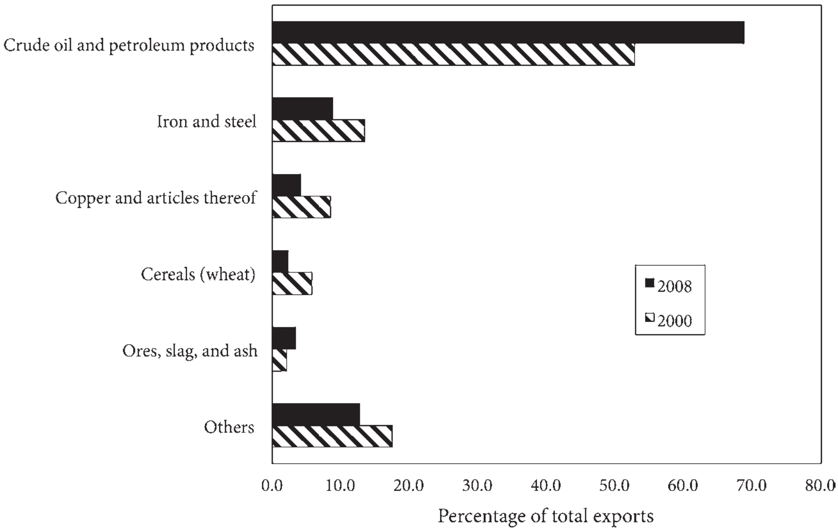

Figure 2.2. Kazakhstan's export structure. *Source*: UN Comtrade Database.

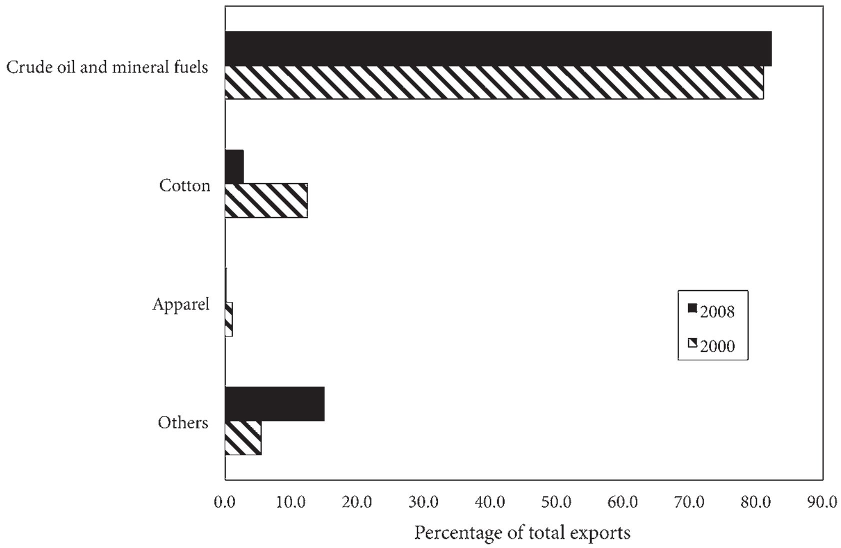

Figure 2.3. Turkmenistan's export structure. *Sources*: UN Comtrade Database; International Trade Centre.

hardly be regarded as high-value-added manufactured products. Despite the Industrial and Innovative Development Program and import substitution measures adopted by the Kazakh government, the shares of more complex skill-, technology-, and capital-intensive sectors—machinery, electronics, telecommunication, and transport equipment—in total exports (both including and excluding oil) remain modest (see also figure 2.13 in the appendix). The only shift toward value-added production seems to have occurred in the chemical industry of Kazakhstan, which exploits vertical complementarities in the hydrocarbon value chain. Finally, Kazakhstan has traditionally been a big exporter of wheat to the world markets.

Turkmenistan's hydrocarbon dependency is even more pronounced, and its economy is much less diversified than that of Kazakhstan. Natural gas exports account for about 82 percent of total exports (see figure 2.3). Aside from natural gas, cotton fiber and textiles play a prominent role in Turkmen exports. Textile production increased in 2000–2008 due to large foreign investments from Turkey and Korea. Turkmenistan also produces chemicals, but their relative weight has declined, indicating contraction in one of the few value-added industries.

Figures 2.4, 2.5, and 2.6 compare the composition of exports between 2000 and 2008 for Kyrgyzstan and Tajikistan. The data suggest that the export structure in these countries too is oriented toward mining, agriculture, and simple labor-intensive manufacturing, and no major structural changes took place between 2000 and 2008.

The main export commodity of Kyrgyzstan is gold. Its share in total exports, however, shrank from 39 percent in 2000 to 30 percent in 2008. Somewhat surprisingly, petroleum oil products (benzene, kerosene) were the third-largest export category in 2008, though Kyrgyzstan does not produce much crude oil itself. In fact, it re-exported a big portion of Kazakhstan and Russian petroleum imports. In particular, kerosene was sold to the American air base for refuelling military airplanes.

Apparel is the second-largest category in the Kyrgyz exports. It consists of domestically sewn clothing as well as Chinese garments, which are exported to Russia, Kazakhstan, and Uzbekistan. Yet the official figures significantly underestimate imports and subsequent re-exports of Chinese textiles and apparel by small shuttle traders through the intra-regional bazaars (Dordoi and Kara-Suu) located on Kyrgyz territory. And this is not only due to smuggling and corruption. Perhaps a more important reason is that the Kyrgyz custom regulations permit small

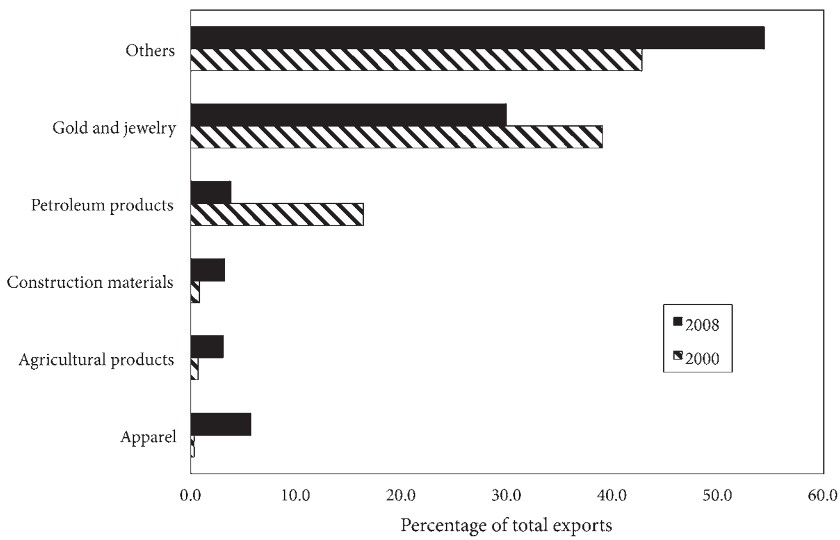

Figure 2.4. Kyrgyzstan's export structure. *Source*: UN Comtrade Database.

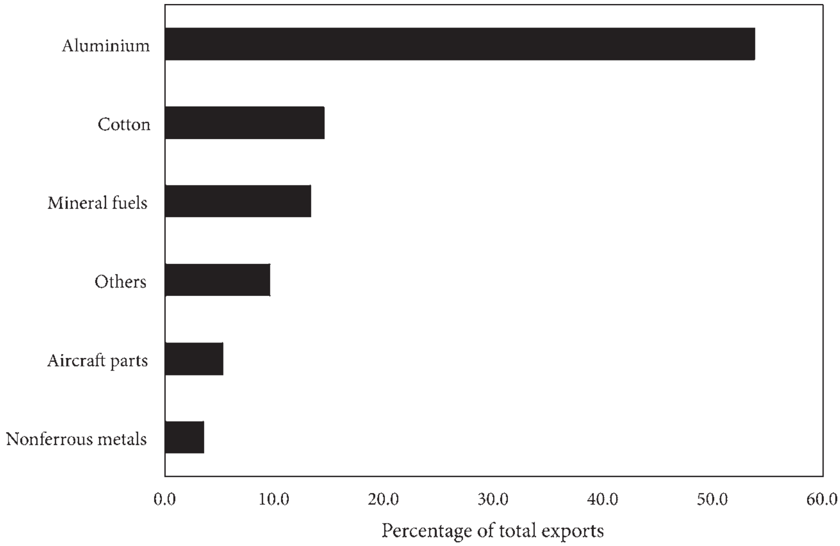

Figure 2.5. Tajikistan's export structure (2000). *Source*: UN Comtrade Database.

traders to pay duties based on weight rather than value of garments, which are light. As a result, a lot of trade goes unrecorded. Based on the mirror trade statistics and unexplained entries in the balance of payments, Kaminski (2008) estimates the country's unregistered re-exports of Chinese consumer goods at $100 million a year, or about 10 percent of total exports in 2006. By taking advantage of its WTO membership, proximity to China, and more liberal customs regime, Kyrgyzstan emerged as a regional re-export hub for Chinese consumer goods.[12] The Kyrgyz intra-regional bazaars present an interesting model of building economic niches and exploiting geo-economic opportunities.

A somewhat different economic strategy is being pursued by Tajikistan. Tajik exports have been dominated by unwrought aluminum and cotton fiber (see figures 2.5–2.6). The share of aluminum in total exports shot from 54 percent in 2000 to 72 percent in 2008, reflecting the extreme skewedness of Tajikistan's economy. Tajikistan has made considerable efforts to diversify its economy and reduce dependence on hydrocarbon imports through development of its hydroelectric sector.

Located on the Pamir mountain range, the source of some of the most powerful mountainous rivers, Tajikistan is endowed with a colossal hydropower potential. During Soviet times, a cascade of hydropower stations was built on the river Vakhsh, a tributary of Amu Darya. The electricity generated by these plants is used for both domestic and industrial purposes, including aluminum production. Tajikistan has recently augmented this Soviet-era hydroelectric cascade by a few new power stations. In 2008 hydroelectricity exports climbed to 4.2 percent of total exports.

Finally, figure 2.7 reveals that Uzbekistan's industrial output has a relatively more diversified pattern, partly because it has not gone through a market economic transformation.[13] In 2008 Uzbek industrial output was dominated by natural gas and oil (20 percent), followed by machinery (16 percent), textiles (13 percent), and nonferrous metals (12.5 percent). As in Kazakhstan and Turkmenistan, Uzbek hydrocarbon production surged from 15 percent in 2000 to 20 percent in 2008. In contrast to its neighbors, Uzbekistan managed to increase production of machinery and equipment, which comprises automobiles made at the joint Uzbek-Korean plant UzDaewoo, tractors, and other agricultural equipment. Uzbekistan also exports some chemicals and plastics.

Concentration of exports in a few primary commodities has adversely affected the manufacturing sectors of the Central Asian economies. For example, the overreliance on hydrocarbon exports coupled

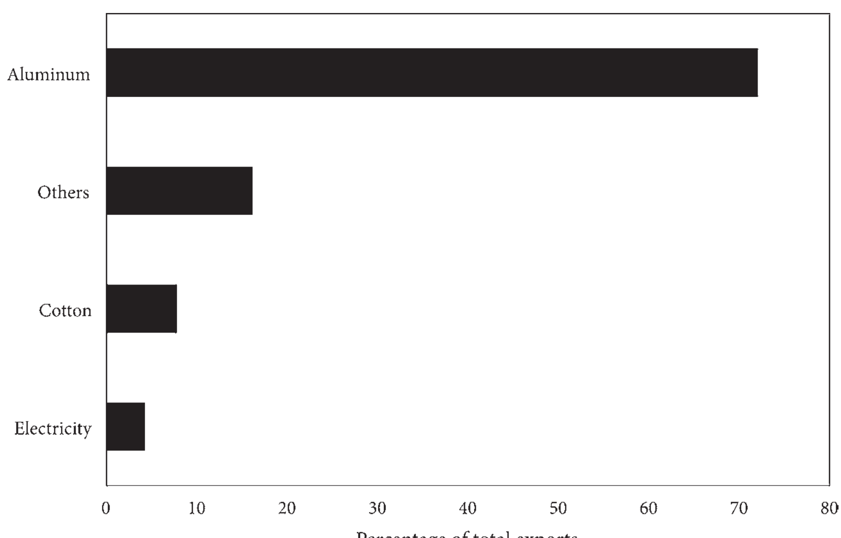

Figure 2.6. Tajikistan's export structure (2008). *Source*: UN Comtrade Database.

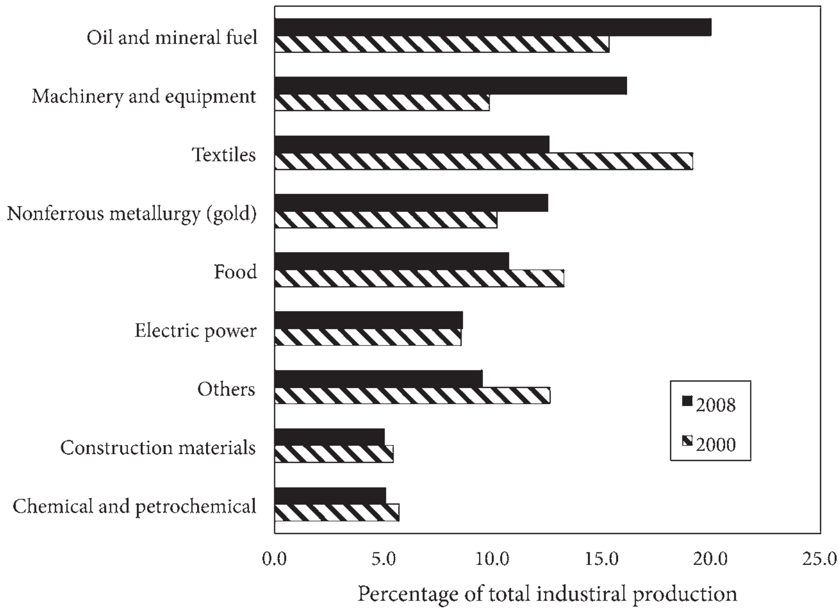

Figure 2.7. Uzbekistan's industrial output. *Source*: Uzbekistan National Statistics Committee.

with rigid exchange rate policies led Kazakhstan and Turkmenistan to exhibit symptoms of the "Dutch disease," including real appreciation of their national currencies. This has impaired the competitiveness of their manufacturing sectors and hampered economic diversification. The manufacturing value-added (MVA) per capita figures for the Central Asian countries are below those for the Baltic states and the Eastern and Southern European transition economies. For instance, Kazakhstan, which has the largest industrial base in the region, trails behind Latvia and Bulgaria—laggards in their own regional groupings—in terms of MVA per capita and machinery production.

To conclude, the Central Asian republics have dramatically expanded their exports over the last decade. However, the highly skewed structure of exports makes the Central Asian states vulnerable to abrupt swings in world commodity prices, as demonstrated by the global financial crisis in 2008–2009, and jeopardizes their future growth prospects. Moreover, the resource rent dependence may conserve the region's industrial backwardness and hinder economic diversification.

Macroeconomic Policies

By and large, the fiscal and monetary policies remained sound until the onset of the financial crisis. The average budget deficit was as little as 1 percent of GDP. The three hydrocarbon-exporting countries accumulated fiscal surpluses in the range of 3–7 percent of GDP, while Kyrgyzstan and Tajikistan ran deficits within an acceptable range of 3–4 percent of GDP (see figure 2.8). This was achieved through drastic cuts in public expenditure from 45–50 percent of GDP to about 30 percent of GDP. These cuts in public spending, however, did not significantly lower GDP, as exports grew and external loans poured into the region. Furthermore, Kazakhstan and Kyrgyzstan implemented significant tax reforms: the number of taxes was cut, as were their rates, including a flat income tax of 10 percent and favorable tax regimes for small and medium enterprises.

On the monetary side, the broad money supply had been growing on average at 36 percent a year. Even so, monetary expansion did not result in rising inflation until 2005, because of the preceding great demonetization in the early 1990s (see figure 2.9). The median inflation remained below 10 percent a year. Inflation, however, began to pick up in 2005,

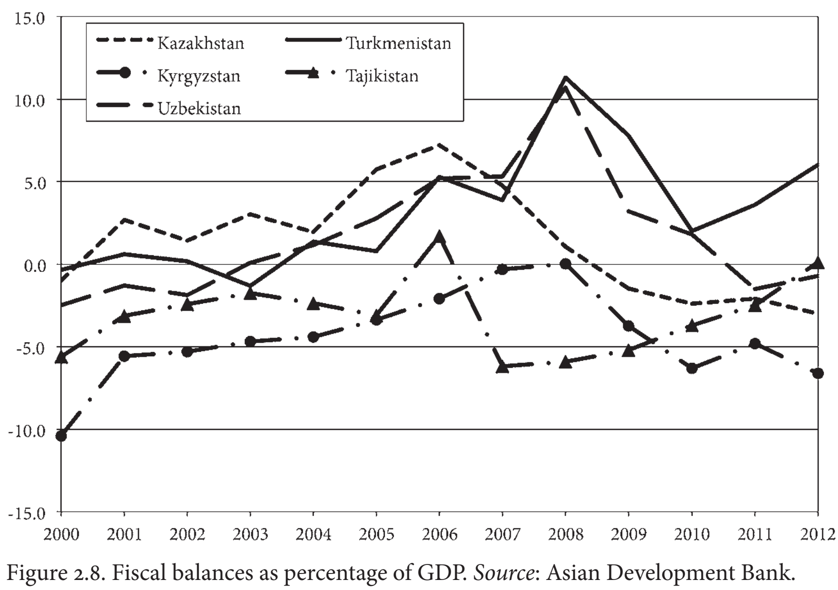

Figure 2.8. Fiscal balances as percentage of GDP. *Source*: Asian Development Bank.

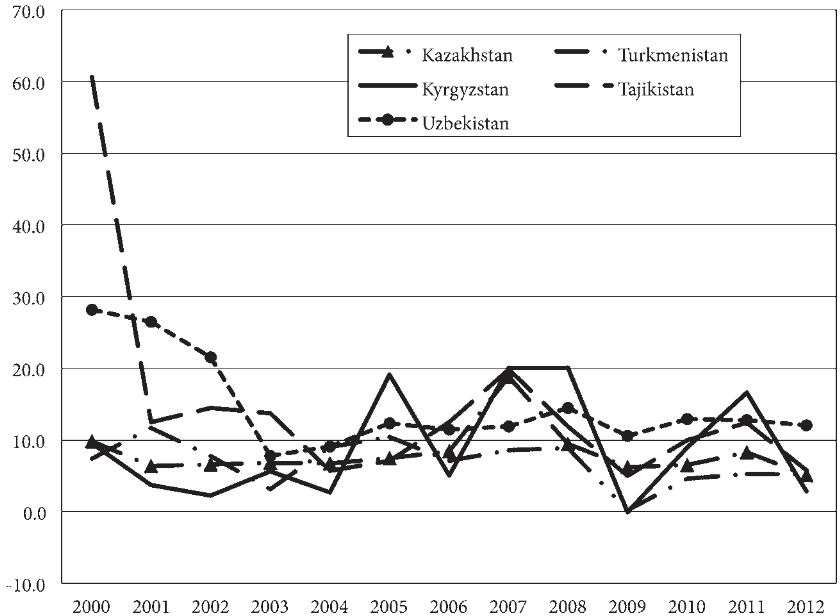

Figure 2.9. Inflation (end-of-year change in consumer prices). *Source*: International Monetary Fund, *World Economic Outlook*.

reaching two-digit levels by 2008. It started as a typical demand-pull inflation spurred by buoyant receipts from the minerals sector and excessive credit growth in some countries, notably in Kazakhstan. Yet in 2007–2008, additional cost-push factors set in. Rising global food and fuel prices put a strong upward pressure on consumer prices. As a result, CPI inflation jumped to 20 percent a year in Kyrgyzstan and Tajikistan; while Turkmenistan and Uzbekistan, being net energy exporters, experienced a slightly moderate inflation of 8–14 percent a year, stemming mostly from food price shocks.

In Kazakhstan, inflation was exacerbated by the fixed exchange rate regime and excessive foreign borrowing by domestically owned commercial banks. The illusory safety of the stable exchange rate attracted large inflows of short-term lending from Western banks. Most of this debt was private bank borrowings. The currency flows fueled a speculative construction boom and inflationary consumption. Real estate prices spiraled out of control, and white-collar salaries spiked to unprecedented levels. Kazakhstan continued to build up foreign debt until the world financial crisis. By the end of 2007, its total external debt soared to 94 percent of GDP. By contrast, the remaining Central Asian countries substantially reduced their external debt (see figure 2.10).

Finally, the external position of the Central Asian states improved in 2000–2008, reflecting increased export volumes and high commodity prices rather than a conscious policy to reduce deficits. Uzbekistan and Turkmenistan recorded significant current account surpluses (see figure 2.11). Despite its trade surplus, Kazakhstan's current account balance remained in negative territory due to large factor income outflows and debt service payments. The current account deficits in Kyrgyzstan and Tajikistan hovered within a reasonable 3–4 percent of GDP. They were mainly financed by migrant worker remittances from Russia and Kazakhstan. Unregistered re-exports of Chinese consumer goods were an additional source of funding in Kyrgyzstan. The spillovers from the Russian and Kazakh growth through increased remittance flows thus mitigated the adverse effect of high fuel prices on the current accounts of the hydrocarbon importers.

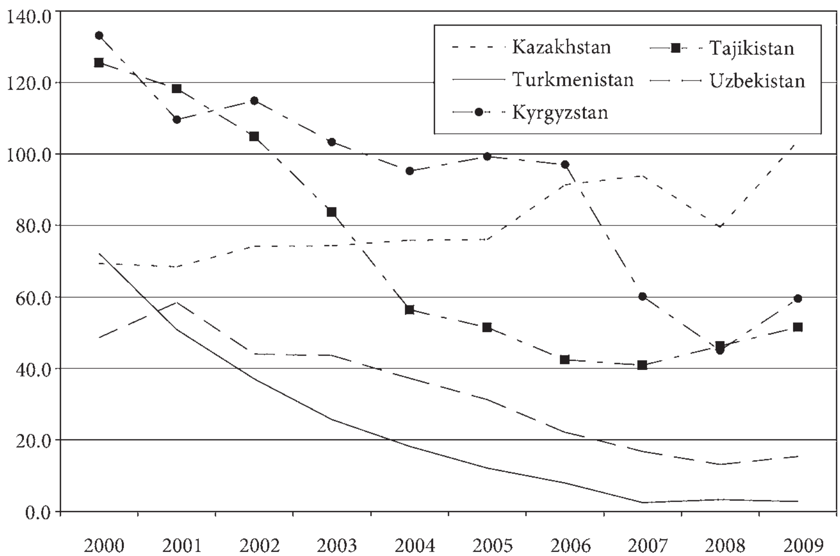

Figure 2.10. External debt as percentage of GDP. Source: Asian Development Bank.