

# China

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There are presently two forces at play in China's engagement with Greater Central Asia that will fundamentally shape the concept of trade on the Eurasian continent: China is strengthening bilateral trade ties with all of its Greater Central Asian neighbors; and the continental transport corridor running from China to Europe is developing at a rapid pace. In light of the geographical proximity between Greater Central Asia and China and the historical connection between Asia and Europe on the Silk Road, it is not surprising that these developments have gathered such momentum. The damage caused by the Soviet legacy on the economies of Greater Central Asia is slowly disappearing and short- as well as long-distance trade is taking root. Growing ties between China, South Asia, and the Middle East put Greater Central Asia at the cross-roads of the Eurasian continental trade corridors, opening alternatives to the Central Asian states. For the first time in a century the Greater Central Asian states can trade freely with their friends in the south, east, and west. Provided that governments in Greater Central Asia and China pursue favourable trade policies and reduce border inefficiencies, they have the potential to raise GDP, increase state income, and make full use of the complementarities that exist among their economies.

The dynamics here should not be mistaken. Trade between China and the post-Soviet states in Central Asia has greatly increased from virtually zero since the collapse of the former Soviet Union in 1991.<sup>1</sup> Today, according to

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<sup>1</sup> For other assessments of this development see for example, John W. Garver, "Development of China's Overland Transportation Links with Central, South-west

Chinese Customs Statistics the total trade volume between China and Central Asia has increased from approximately \$465 million in 1992 to \$7.7 billion in 2005. In 2002, for instance, total trade volume reached a modest \$2.4 billion, while 2003 saw an increase to \$4.1 billion. The 2004 figure of \$5.8 billion then increased by 72.5 percent to an all-time high of \$7.7 billion (see Appendix 1).<sup>2</sup>

At the same time, the so-called “second Euroasian land-bridge” running from China’s coast in Lianyungang to Rotterdam via Xinjiang and Greater Central Asia, has attracted increasing interest. This will result in great savings in transport time that will be possible thanks to infrastructural developments in Greater Central Asia and China. For example, the sea journey from China to Europe takes twenty to forty days, whereas cargo transported by railway from Lianyungang to Rotterdam via the second Eurasian land-bridge promises to cut transport time down to just eleven days.<sup>3</sup>

Despite these ties, bilateral trade with Central Asia is still in its infancy, and continental land trade with the West could stall unless substantial efforts are devoted to facilitate it. To put things in perspective, only 1 percent of China’s total foreign trade is with Greater Central Asia, despite significant complementarities among the economies, and China’s trade relationship with other neighboring regions is stronger than those with Greater Central Asia. Without necessary infrastructural investments, bilateral trade is unlikely to

and South Asia,” *China Quarterly* 2006; Vladimir Paramonov, “China and Central Asia: Present and Future Economic Relations,” Conflict and Studies Research Centre, Central Asian Series 05/25 (E), May 2005; Martin Spechler, “Crouching Dragon, Hungry Tiger: China and Central Asia,” *Contemporary Economic Policy* 21, 2 (2003); P. H. Loughlin & C. W. Pannell, “Growing Economic Links and Regional Development in the Central Asian Republics and Xinjiang,” *Eurasian Geography and Economics*, 42, 7 (2001): 207-217; Hsiu-Ling Wu & Chien-Hsun Chen, “The Prospects for Regional Economic Integration between China and the Five Central Asian Countries,” *Europe-Asia Studies* 56, 7 (November 2004); ADB, Xinjiang Autonomous Region, PRC: Trade Facilitation and Customs Cooperation Project, Draft Technical Assistance Consultant’s Report, November 2005.

<sup>2</sup> The 2005 figure is based on the period from January to November, which means that the figure reached over \$8 billion.

<sup>3</sup> Xinjiang Autonomous Region, PRC: Trade Facilitation and Customs Cooperation Project, Draft Technical Assistance Consultant’s Report, November 2005.

reach its full potential, and transport along the second Eurasian land bridge will continue to be limited. Despite potential time and cost savings of transport by land across Central Asia, more than 95 percent of Chinese goods destined for Europe are currently transported via sea or by much more complicated systems using Russia.<sup>4</sup> For example, seaborne transport from Asia to Europe via the Suez Canal, or on the first Eurasian land bridge via Russia on the trans-Siberian railway (Nakhodka-Moscow). Impediments in informal charges, border delays, and capacity constraints on the route reduce potential gains.<sup>5</sup> Prices, costs, and transit times are often highly arbitrary, which affect Central Asia's competitiveness. While some of these factors could be ascribed to the topography of the region, the majority are man-made: customs rules change frequently, border crossings are inefficient, and customs declarations are not standardized.<sup>6</sup>

The transactional costs imposed by these impediments are unfortunate for all states involved. Natural specialization could be achieved by opening old trade routes and encouraging greater inter-state cooperation. For example China is now tapping into Central Asian energy resources and Kyrgyzstan has taken steps to supply Afghanistan with building materials. Beyond this, cotton from Tajikistan could be exported to Turkey, China, and Pakistan, and Pakistani producers could compete with Chinese and Indian manufacturers.<sup>7</sup> Electricity from Tajikistan and Kyrgyzstan could alleviate the critical situation in the Afghan and Pakistani power supply, and China could provide Greater Central Asia with technology and manufactures. Trade policies should reflect these larger emerging forces and avoid regimes solely focused on intra-regional trade, especially those designed by Russia to maintain influence over its former dependents. This chapter aims to explore these

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<sup>4</sup> Xinjiang Autonomous Region, PRC: Trade Facilitation and Customs Cooperation Project, Draft Technical Assistance Consultant's Report, November 2005. p.3.

<sup>5</sup> Ibid, p. 32.

<sup>6</sup> Sena Eken, Presentation to the CAREC Trade Policy Coordinating Committee' pp.11, <http://adb.org/Carec/documents/tpcc.pdf> (accessed on 30 January 2007)

<sup>7</sup> Frederick Starr, "Central Asia's Reemerging Transport Network: Promise and Perils for Mountainous Regions," Paper for the International Workshop Strategies for Development and Food Security in Mountainous Areas of Central Asia, Dushanbe June 6-10, 2005, p.6.

prospects and problems by estimating the potential gains in continental and regional trade, by establishing what the regional trade patterns look like, what bottlenecks exist, how these bottlenecks can be alleviated, and what costs are involved. We will start with a brief overview of China's trade with Greater Central Asia and its significance.

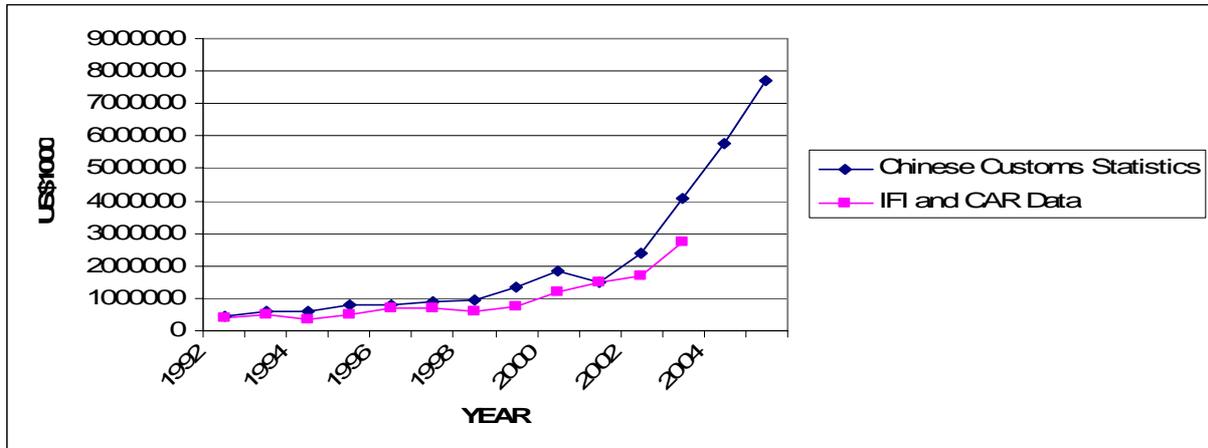
### **China's Trade and Interests in Greater Central Asia and Beyond**

Since World War II there have been four main phases in China's border trade with its western neighbours in Central Asia: 1949--85; 1986--90; 1991--2000 and 2001--to the present. In 1949 an agreement was signed with the Soviet Union on cross-border trade between Soviet and Chinese state companies. This was followed with the opening of four border trading zones in Horgos, Turugart, Jimnay, and Baktu, but these were subsequently closed between 1963 and 1967 due to political factors. As a result, all border trade ceased. Trade resumed in 1982, but was not formally recognized until 1986, when China began to reform its foreign trade policies. On September 12, 1990, the railways of China and the Soviet Union were connected at the Druzhba-Ala Pass in Xinjiang, laying the groundwork for the second Eurasian land bridge. The disintegration of the Soviet Union led to greater trade with Central Asia, reflected in cross-border trade figures topping \$464 million in 1992—a growth of 65 times the value of 1986. In the early 1990s, several agreements were signed between Xinjiang Transport Cargo Bureau and its Kazakh counterpart resulting in the opening of five land routes for passenger transport and cargo freight.<sup>8</sup> This laid the foundation for the massive expansion of border trade that has occurred during the fourth phase since 2000.

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<sup>8</sup> Xinjiang Autonomous Region, PRC: Trade Facilitation and Customs Cooperation Project, Draft Technical Assistance Consultant's Report, November 2005. pp.12–18.

Graph 1. China's Trade with Central Asia 1992-2005



As illustrated in Graph 1, China's trade with Central Asia grew steadily from 2001 through the end of 2005.<sup>9</sup> Interestingly, accounts of bilateral trade differ widely depending on the source, which can help in discerning the extent of the shuttle trade.<sup>10</sup> While Chinese Customs Statistics include shuttle trade in their estimates, the IMF does not.<sup>11</sup> Even though estimates using this method should be treated with caution, it is possible to get an idea of the extent of both official trade and shuttle trade. The extent of the shuttle trade also reveals foregone state income and, as shuttle trade to a large degree is an effect of trade barriers, it gives an indication of the potential gains that governments could reap by reducing these barriers.<sup>12</sup> Neither of these methods includes illegal trade, which is substantial in all states. Indeed, and today both legally and illegally Chinese goods are now flooding the bazaars of Central Asia at the cost of Russian and internally produced goods.

<sup>9</sup> This growing trend is confirmed by data from International Financial Institutions (IFI) and the Central Asian Republics (CARs) national statistics (pink graph).

<sup>10</sup> Shuttle trade is defined as the activity of individual persons and entrepreneurs purchase goods across the border which they import for resale in bazaars and street markets. These goods are often imported without full declaration to escape from import duties, see *Measuring the Non-Observed Economy: A Handbook*, (Paris: OECD, 2002) OECD, IMF, ILO, Interstate Statistical Committee of the Commonwealth of Independent States, 2002, Annex 2, Glossary.

<sup>11</sup> Vladimir Paramonov, "China and Central Asia: Present and Future Economic Relations," Conflict and Studies Research Centre, Central Asian Series 05/25 (E), May 2005, p.3.

<sup>12</sup> Increasing Gains from Trade Through Regional Cooperation in Trade and Policy and Customs Transit, Asian Development Bank, Manila, April 2006, p.32.

China is not the only power that has expanded its economic ties with the Central Asian states, however. Russia's overall trade volume with Kazakhstan, for example, has grown steadily from approximately \$3.8 billion in 1998, to \$4.8 billion in 2001, to top \$8.1 billion in 2004.<sup>13</sup> Yet China's total trade volume with Kazakhstan has expanded even faster, from a modest \$635.5 million in 1998 to almost \$4.5 billion in 2004, according to Chinese Customs Statistics (see Appendix 1). Even though China has some way to go before it surpasses Russia's trade volume with Kazakhstan, Beijing has demonstrated its intention to make full use of the competitiveness that exist between the economies of China and Central Asia.

China is particularly interested in Central Asian energy resources, while Central Asia needs consumer and manufactured goods. Apart from the logic of the market and the mutual benefits that both parties could reap by trading, regional economic cooperation brings comprehensive gains for China in the political, security, and economic spheres.

The northwest region of Xinjiang is the main Chinese beneficiary of economic cooperation with Central Asia. Indeed talking about bilateral China-Central Asian trade is somewhat misleading as the Xinjiang region accounts for over 80 percent of the total Chinese trade volume with Central Asia.<sup>14</sup> Moreover, Chinese trade is heavily directed towards one trading partner, Kazakhstan. China's trade with Kazakhstan was close to 80 percent of total trade with Central Asia in 2005, while trade with Turkmenistan was just over 1 percent of the total bilateral trade with the region.<sup>15</sup> Though one may speak of Sino-Central Asian trade, the very large majority of this trade takes place around the border regions of Xinjiang and Kazakhstan and to a lesser degree around Kyrgyzstan.<sup>16</sup> This is especially important for

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<sup>13</sup> IMF Country Report No. 05/378, Russian Federation: Statistical Appendix, October 2005, see Table 26. Russian Federation: Origin of Imports, 1998-2004 and Table 24. Russian Federation: Destination of Exports, 1998-2004.

<sup>14</sup> Wang Haiyan, "Xinjiang's Position in China's Economic and Trade Relations with Central Asia," *Markets of Russia, Central Asia and Eastern Europe 2* (2006), p.33.

<sup>15</sup> Based on figures for 2004, see, "Yearbooks of China's Customs Statistics", 2004, China's Customs Press, Beijing.

<sup>16</sup> Explanations for this concentration of trade to the border regions can partly be explained by the Chinese border trade policy. This policy entails a promotion of border

Afghanistan and Tajikistan, both of which could be prominent trading partners for China.

### **The Rationale Underlying Chinese Engagement**

Five motives drive Chinese engagement in Central Asia: the economic development of Xinjiang; domestic political stability; regional stability; energy security; and the creation of an alternative transport corridor to Europe.

Through China's "develop the west" program, launched by Chinese President Jiang Zemin in 1999, China has sought to integrate the western region of China into the booming Chinese economy, and make it more competitive. Though the western development program includes Tibet, Qinghai, Gansu, Sichuan, Yunnan, Shaanxi and Guizhou provinces in addition to Xinjiang, Xinjiang has been the main area of focus. Sharing a 3,500 km long border with the Central Asian republics, Xinjiang's economic integration is of crucial importance for its development. As such, development of Xinjiang's infrastructure has been a prime concern. Today, the infrastructure of Xinjiang is comparatively well developed with 11 airports, 3,361 km of railway, 80,900 km of road network, a highway running across the Taklimakan desert, and modern telecommunications.

A precondition for this development, however, has been a massive resource transfer from Beijing for the development of infrastructure, including road and rail ties between China's east and west. For example, the 4,395 km national highway from Lianyungang to the Horgos customs point in Xinjiang, which opened in 2004, cuts cross-country transport time from 15

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trade with neighbouring regions and use increased economic interaction to promote stability and growth. Specifically, it aims to facilitate exchange between inhabitants living within 20km of the Chinese border and neighbouring countries; to ease restriction on small-scale border trade; reducing tariffs and import turnover taxes by half for border trade; as well as reducing restrictions on goods brought into the country for the purpose of economic or technology collaboration projects, see Hsiu-Ling Wu & Chien-Hsun Chen, 2004, p.1071.

days to 50 hours.<sup>17</sup> The real impact of the Chinese “develop the west” policy, however, is still to be seen, as crucial bottlenecks remain.<sup>18</sup>

By deepening economic cooperation between China (especially Xinjiang) and Central Asia, China seeks to diminish the influences of those groups that promote ethno-religious extremism and separatism.<sup>19</sup> China fears that these influences will spill over into Xinjiang, due to the historical trans-border interactions between these peoples. China’s policy is fairly straightforward: to increase incentives to Central Asian governments that assist in repressing “East Turkestan” secessionist forces, and not to let Central Asia become a base from which secessionists can operate.<sup>20</sup> This promotion of China’s territorial integrity has been promoted both on a bilateral and multilateral level through the SCO.

Second, as repeatedly demonstrated in the past, drastic shifts in Central Asia tend to create problems for China. From the Manchu’s establishment of the northwest province of Xinjiang in the 1860s to the Republic Revolution in 1911, this region has seen several major revolts, most of which are believed to have been instigated and supported by those with an anti-Chinese agenda. Mass ethnic upheavals in the 1940s and emigration to the Soviet territory in the 1960s were unwelcomed external influences from Soviet Central Asia.<sup>21</sup>

China’s present concern over possible turmoil in this region is clearly demonstrated in its very nervous reaction to the March 2005 Tulip Revolution in Kyrgyzstan. In addition to fear of a domino effect and growing

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<sup>18</sup> Hongyi Harry Lai, “China’s Western Development Program: Its Rationale, Implementation, and Prospects”, *Modern China* 28, 4 (2002): 451-453.

<sup>19</sup> “China, Russia, CIS nations to fight terrorism”, *Daily Excelsior*, Jammu, India, June 16, 2001

<sup>20</sup> Hsiu-Ling Wu & Chien-Hsun Chen, 2004; For an early assessment of this see, Lilian Craig Harris, “Xinjiang, Central Asia, and the Implications for China’s Policy in the Islamic World,” *The China Quarterly* 133 (1993), pp. 111-129.

<sup>21</sup> Zhao Changqing, “China’s Strategic Interests in Central Asia”, *Central and West Asia Studies*, No. 2, 2005

regional instability, China's support of the Uzbek government following the Andijan events of 2005 further confirmed its dedication to the status quo.<sup>22</sup>

Third, China hopes for a relatively secure energy supply from Central Asia and especially Kazakhstan. Such energy links would benefit the cooperative political structures that have been initiated in the region, but which have encountered problems. Economically it would benefit the states in the region by decreasing costs and securing long-term energy security. China needs to diversify its energy supplies. By relying on oil transported by sea lanes through the Malacca Straits China places itself in an insecure position since those straits are often closed to Chinese transports.<sup>23</sup> Currently, there is also a premium of US\$1–2 per barrel on the oil that is imported to Northeast Asia due to world demand on Middle-Eastern oil, and to the simple reality of distance.

To reduce dependence on the Malacca Straits China has shown a keen interest in the alternative route via the port of Gwadar in Pakistan, in which China has invested over \$200 million.<sup>24</sup> To transport energy supplies from the Gwadar port, China has made efforts in rehabilitating the 616 km Karakorum highway linking Pakistan with Xinjiang, although this is unlikely to carry more than a little oil. Plans are also underway to build a highway linking Gwadar with Kandahar and Islamabad, as well as to the east-west trunk railroad from Urumchi to Kashgar.<sup>25</sup>

Fourth, the construction of the second Eurasian land bridge via Central Asia and Xinjiang will reduce the over-load at Chinese ports on the east coast. Development of the corridor will also increase access by China's underdeveloped western regions to world markets and balance the wealth gaps within China. Large oil deposits in Kazakhstan and Azerbaijan and gas deposits in Turkmenistan are already drawing Chinese attention, leading to

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<sup>22</sup> Stephen Blank, "Islam Karimov and the Heirs of Tiananmen", *Eurasia Daily Monitor*, Vol. 2, No.115, June 14, 2005

<sup>23</sup> Niklas Swanström, "An Asian Oil and Gas Union: Prospects and Problems," *CEF Quarterly* 3, 3 (2005), p.88.

<sup>24</sup> Tarique Niazi, "Gwadar: China's Naval Outpost on the Indian Ocean," *China Brief*, January 16 2005.

<sup>25</sup> Frederick Starr, "Central Asia's Reemerging Transport Network", 2005 p.2.

expanded political interaction. In the case of Azerbaijan alone this has led to the Chinese showing interest in developing the Baku-Tbilisi-Kars railway corridor, as well as to further multiple production-sharing agreements with the Azerbaijan State Oil Company following a 2004 grant by China's Shengli Oil Company to develop the Garachukhur oil field.<sup>26</sup>

### **Assessment of Possible Gains and Benefits from Continental and Regional Trade Involving China and Greater Central Asia**

What are the potential gains to China from continental and regional trade? Today, trade between the Asia-Pacific region and Europe exceeds \$300 million per year, and stifling congestions at Chinese ports, combined with increasing freight rates for maritime shipments, have led Chinese producers to look for alternative overland trade routes. In comparison to the sea-routes via Asia and Europe, whose freight costs can reach as much as \$167 per ton and take 45 days, the second Eurasian land-bridge could cut transport time by more than half and cost only \$110 per ton<sup>27</sup>. Instead of the 26,000 km detour to Europe by sea, the second Eurasian land-bridge reduces distance to 6,379 km, translating into a cost saving of 30 percent for forwarders<sup>28</sup> promising significant transit fees and greater market access for Greater Central Asia not to mention the environmental benefits. Beyond this, of course is the opportunity cost to China if it decides not to participate.

The few estimates of potential benefits to China of continental trade tend to be highly speculative.<sup>29</sup> For example, the Institute of Spatial Planning & Regional Economy State Development Planning Commission of the People's

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<sup>26</sup> Fariz Ismailzade, "Azerbaijan and China Move to Increase Security and Economic Cooperation," *Eurasia Daily Monitor* 2, 56 22 March, 2005.

<sup>27</sup> Xinjiang Autonomous Region, PRC: Trade Facilitation and Customs Cooperation Project, Draft Technical Assistance Consultant's Report, November 2005, p.31

<sup>28</sup> *Ibid.*, p. 31.

<sup>29</sup> There is to the authors awareness no such study to date. The ADB, Xinjiang Autonomous Region, PRC: Trade Facilitation and Customs Cooperation Project, Draft Technical Assistance Consultant's Report, November 2005 bring up potential gains and impediments on the route but does not quantify them. With regard to Central Asia there are a few more quantitative studies made on potential gains with trade facilitation. For a literature review on quantitative studies on trade facilitation see, "Quantitative Assessment of the Benefits for Trade Facilitation", OECD TD/TC/WP, (2003)31, Paris, 2003. (Unclassified).

Republic of China estimates that trade barriers on the second Eurasian land bridge reduced Chinese GDP by 13 percent in 2000,<sup>30</sup> which places the opportunity cost at roughly \$130 billion.<sup>31</sup> This is certainly an overly optimistic forecast. An Organization for Economic Cooperation and Development (OECD) report suggests that gains from trade facilitation will be between 0.04 percent and 2.3 percent of GDP.<sup>32</sup> Land-locked countries with protectionism, inadequate infrastructure, and slow borders have most to gain, and could raise their GDP by as much as 2.3 percent. Moreover, a recent Asia Development Bank (ADB) report, "Central Asia: Mapping Future Prospects to 2015," echoes these figures and forecasts GDP growth of about 2 percent, depending on the trade facilitation measures implemented.<sup>33</sup> In contrast, recent United Nations Development Program (UNDP) estimates suggest that GDP could be 50-100 percent higher in a 10 year-period Central Asia if impediments to transport and trade were removed and a program of regional cooperation implemented.<sup>34</sup> On the basis of these projections it seems that potential gains for Xinjiang and Greater Central Asia would involve at least a yearly 2% GDP raise.<sup>35</sup>

It would seem likely that Xinjiang's GDP - starting from a higher base - would increase by less than that of Central Asia. This would be due to its

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<sup>30</sup> Institute of Spatial Planning & Regional Economy State Development Planning Commission P.R.China, Study on the Development and Opening-up of the New Asian-Europe Continental Bridge Area (China's Side), <[http://www.ecdc.net.cn/events/asian\\_europe/](http://www.ecdc.net.cn/events/asian_europe/)> (accessed on 15 May, 2006)

<sup>31</sup> In the same year China's total logistics costs represented 17,7 percent of GDP which should be compared to the U.S. average of 10 percent, see "Going Intermodal," *The China Business Review*, August 10, 2005.

<sup>32</sup> "Quantitative Assessment of the Benefits for Trade Facilitation", OECD TD/TC/WP, (2003)31, Paris, 2003. (Unclassified), Table 5, p.16.

<sup>33</sup> Malcolm Dowling and Ganeshan Wignaraja, Central Asia: Mapping Future Prospects to 2015, Asian Development Bank, Manila, April 2006, p.2.

<sup>34</sup> See Malcolm Dowling and Ganeshan Wignaraja, *Central Asia After Fifteen Years of Transition*, ADB Working Paper Series on Regional Economic Integration (July 2006), p. 17, <<http://aric.adb.org/pdf/workingpaper/WP3%20CARS%20230706.pdf>> (accessed 30 January, 2007).

<sup>35</sup> This difference is probably a result of how many factors that are included in the model. The OECD trade facilitation estimates seem to be more limited focusing mostly on increasing border-efficiency and infrastructure and logistics impediments, while the ADB and UNDP estimates appears to be more comprehensive.

more developed infrastructure, China's membership in the World Trade Organization (WTO) and its more favourable trade policies. Because the current foreign trade as share of GDP is higher in Central Asia than in Xinjiang, the latter has comparatively more unrealized foreign trade potential. While total foreign trade (exports plus imports) in Xinjiang amounted to \$5.6 billion in 2004 and represented 20 percent of total GDP, the Chinese average was 75 percent. This suggests that there is considerable potential for Xinjiang's foreign trade to raise GDP significantly should access to western markets be improved.<sup>36</sup>

The role of Xinjiang as a transit region will also increase significantly in the coming years, although the volume of transit-trade through Xinjiang today already is much larger than actual import and exports to and from the region. The current total value of transit is estimated to be about \$8 to \$10 billion with annual growth reaching at 15 percent.<sup>37</sup> Although the contribution of the transport sector to GDP in Central Asia (and Xinjiang) is in itself relatively small, accounting for 3–8 percent of GDP and aggregate output, the transport sector is crucial for integration and growth in terms of participation in the second Eurasian land bridge and international trade in general.<sup>38</sup>

As with forecasts on GDP increases, quantifiable assessments on the potential magnitude of trade volume on the second Eurasian land bridge are uncertain at best. One assessment suggests that annual income for participating countries could reach “hundreds of millions of dollars” in increased container transit.<sup>39</sup> Yet the second Eurasia land bridge faces fierce competition from alternative routes, primarily from sea transport but also from the first Eurasian land bridge through Russia. Currently, only a sixth of exports from Japan and Korea to Europe are transported via the second

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<sup>36</sup> See ADB, *Xinjiang Autonomous Region*, p. 51 and authors own calculations. This discrepancy could partly be explained by the high share of energy resource extraction in the region and soaring domestic demand.

<sup>37</sup> Description of ADB Technical Assistance Project for Xinjiang, 2006. Provided to authors upon request from CAREC.

<sup>38</sup> ADB, “Increasing Gains From Trade Through Regional Cooperation in Trade Policy and Customs Transit,” April 2006, p. 49.

<sup>39</sup> Mikhail Mostovoy, deputy director general of Ukranian State Rail Administration in “Railways revive the Silk Road,” *Transport Weekly* (?).

Eurasia land bridge. Russia has shown concern over this competitive trunk route, and has made considerable efforts in enhancing the competitiveness of its route via the trans-Siberian railway. Although the corridor through Russia is 1300 km longer than the second bridge, traders and forwarders still prefer this route due to its greater efficiency, Russian tax incentives, customs rebates, and better facilities.<sup>40</sup> It has been estimated that if China attains TIR status, the volume of transit goods on the second land bridge will reach 500 to 600 million tons per year.<sup>41</sup> In addition, when China becomes a member of TIR, Chinese goods also will be more competitive both in the Central Asian states as well as within the European market.

Potential benefits are not limited to China and Greater Central Asia. The recent linkage of the Kars-Akhalkalaki rail network linking Georgia and Turkey on the cross-Caucasus segment of the second Eurasia land bridge, will also boost trade. Cargo from China could be delivered to Aktau in Kazakhstan, sent onward by ferry to Baku, and then shipped to Istanbul and Europe via the railroad link. Estimates suggest that trade volume through this corridor will jump from 2 million tons in the first two years, to 8-10 million tons in the following three years.<sup>42</sup>

Access to ports for Xinjiang and Greater Central Asia will also provide substantial projected benefits. The joint Sino-Pakistani development of the Gwadar port and restoration of the Karakorum highway will lead to an increase in cargo trade volume at Gwadar from approximately 200,000 twenty-foot containers in 2005 to an estimated 295,000 in 2015.<sup>43</sup> This joint development entails that Gwadar will double the capacity of Pakistani oceanic trade and open a “window to the sea” for the landlocked countries in Central Eurasia.<sup>44</sup> Rehabilitation of roads to Afghanistan from the Gwadar

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<sup>40</sup> ADB, November 2005, p. 54

<sup>41</sup> Ibid, p. 28.

<sup>42</sup> Taleh Ziyadov, “The Kars-Akhalkalaki Railroad: A Missing Link Between Europe and Asia,” *Central Asia Caucasus Analyst*, April 19 2005.

<sup>43</sup> Aftab Kazi, Pakistan’s Trade with Greater Central Asia, Pakistan Country Paper, Presented on First Kabul Conference on Continental Trade and Transport, Kabul, Afghanistan, April 1-2, 2006.

<sup>44</sup> John W. Garver, “Development of China’s Overland Transportation Links,” 2006, p. 8.

port will also give Afghan products greater export possibilities and shipping options. Gwadar is closer to Xinjiang than any other saltwater ports in China proper, and will reduce much of the transaction costs currently imposed on trade to and from Xinjiang. Central Asian states will benefit significantly as well, as the port opens the possibilities for promoting their oil trade globally, while Pakistan and Tajikistan are likely to reap new transit fees.

## **Bilateral Trade Patterns and Positions in the Eurasian Continental Trade Network**

### *China and Kazakhstan*

In 1998, China and Kazakhstan finally settled the border dispute that had plagued their relations since Kazakh independence. This laid the foundation for the strong bilateral trade relationship that exists today. Bilateral trade has increased from 37 to 54 percent annually. Trade turnover between Kazakhstan and Xinjiang alone reached \$4,5 – 5 billion by 2004.<sup>45</sup>

The opening of the Atasu-Alashankou pipeline in late 2005 symbolizes the firm ties between China and Central Asia. Continued expansion of this pipeline connects Kumkol in central Kazakhstan with Kenkiyak in western Kazakhstan, providing a possible tap into energy resources flowing from the Caspian by the Atyrau and Chevron-operated Tengiz fields. This promises huge benefits. For example, in the beginning of 2005 Kazakhstan exported merely 25,000 barrels per day (bpd) to China. The Atasu-Alashankou pipeline will initially increase this to 200,000 bpd. When the link between Kenkiyak and Kumkol is completed, exports will likely reach about 1,000,000 bpd.<sup>46</sup>

Kazakhstan is a transit country in trade between China and Azerbaijan, as well as between Russia, Kyrgyzstan, Tajikistan, and Uzbekistan.<sup>47</sup> Thus the

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<sup>45</sup> Kazakhstan mainly exports raw materials to Xinjiang, 58 percent of which are energy resources and 24 percent non-ferrous metals. Xinjiang's exports to Kazakhstan are mainly grain, edible oil, granulated sugar, ketchup, cotton, and textile. figures for 2003, see Vladimir Paramonov, "China and Central Asia: Present and Future Economic Relations," Conflict and Studies Research Centre, Central Asian Series 05/25 (E), May 2005.

<sup>46</sup> "Circumventing the Bear," *Stratfor*, December 16, 2005.

<sup>47</sup> ADB, "Increasing Gains From Trade Facilitation," April 2006, p. 49.

borders at Druzhba-Ala and Horgos have emerged as indispensable nodes in trade between China and Europe.

Shuttle trade between China and Kazakhstan is estimated by the Kazakh Customs Committee to be about \$2–3.5 billion, making it comparable to the official bilateral trade.<sup>48</sup> Cross-border interaction will likely increase further with the opening of the Jeminay border trade zone in 2006.

### *China and Uzbekistan*

Uzbekistan is particularly well-positioned to participate in a continental trade network and serve as a transit country between Kazakhstan and Iran, as well as between Afghanistan, Tajikistan and Kazakhstan. Unfortunately the Uzbek government has failed to capitalize on this position, and its restrictive trade policies have hampered both transit trade and bilateral trade with its neighbors. China is no exception to this. Bilateral trade between China and Uzbekistan has been limited by Uzbek protectionism and the uncertain investment climate since Uzbek independence.<sup>49</sup> Ill-connecting infrastructure with the other Central Asian states has further reduced the competitiveness of the Uzbek economy. As with Kazakhstan, the 1990s saw an incremental increase in total trade turnover except during the period from 1997 to 2001, when bilateral trade plummeted from approximately \$203 million in 1997 to \$40 million in 1999 (Appendix 1). This drop resulted from changing demand in Uzbekistan and China, as well as from the financial crisis in Russia.<sup>50</sup> Since 2002 there has been a steady increase to an all time high of around \$628 million in 2005.<sup>51</sup>

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<sup>48</sup> Vladimir Paramonov, May 2005, p.3.

<sup>49</sup> UNDP, "Bringing Down Barriers: Regional Cooperation for Human Development and Human Security," Central Asia Development Report, UNDP, Bratislava, 2005, p. 61.

<sup>50</sup> Hsiu-Ling Wu & Chien-Hsun Chen, "The Prospects for Regional Economic Integration," 2004, p.1066.

<sup>51</sup> Figures on goods exported from Uzbekistan to China vary substantially. Uzbek state statistics claim that cotton made up only 4 percent percent of total exports in 2003, whereas services accounted for 48 percent, foodstuffs 4,6 percent, machinery and equipment 19 percent, and non-ferrous metals 1.5 percent see Paramonov, "China and

Shuttle trade represents a significant share of the increase in the volume of bilateral trade, although this is less so than in bilateral trade between China and Kazakhstan. The harder border restrictions probably reduce the shuttle trade in Uzbekistan, but recent improvements in Sino-Uzbek relations will likely increase the percentage of official trade in the total.

In 2006 Uzbekistan and China signed many bilateral agreements on trade and energy cooperation, including the \$600 million agreement between the China National Petroleum Corporation and the Uzbek state oil company. At the signing, Chinese President Hu Jintao and his Uzbek counterpart pledged further cooperation in trade, customs, high technology, and energy.<sup>52</sup>

### *China and Kyrgyzstan*

Chinese Customs Statistics show that trade volume between China and Kyrgyzstan was relatively low during the 1990s, ranging from \$100 to \$200 million. On average, trade between China and Kyrgyzstan is similar in volume to Sino-Uzbek trade. However, considering that Kyrgyzstan population is a sixth of Uzbekistan's trade relations between China and Kyrgyzstan are significantly stronger than between China and Uzbekistan. Annual turnover stood at \$202 million in 2002, but reached \$840 million in 2005 (Appendix 1). IMF figures are slightly lower, but the upward trend in bilateral trade is confirmed by Kyrgyz authorities, which suggests trade strengthened from \$74.8 million in 1995 to \$101 million in 2003 (Table 1). Yet the Kyrgyz figures are markedly below those from Beijing.

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Central Asia," 2005, p. 5. Chinese Customs Statistics assert however that cotton, cotton yarn, and cotton fabric made up 84,33 percent of China's imports from Uzbekistan, see "China's Customs Statistics," 2003, from Hsiu-Ling Wu & Chien-Hsun Chen, 2004. China's main exports to Uzbekistan included in 2003 engineering products (48 percent), chemical products (19 percent), and foodstuffs (9 percent), Paramonov, "China and Central Asia," 2005, p. 5.

<sup>52</sup> "China, Uzbekistan sign \$600 million oil agreement," *China Daily*, May 26 2005.

*Table 1. Kyrgyz Republic: IMF Direction of Trade Statistics (w/ China)*  
*(in millions of US dollars)*

|         | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002  | 2003 | 2004<br>Jan.—<br>Jun. |
|---------|------|------|------|------|------|------|------|-------|------|-----------------------|
| Exports | 68.5 | 36.4 | 31.6 | 15.7 | 25.3 | 44.1 | 19.4 | 41.1  | 23.3 | 19.6                  |
| Imports | 6.3  | 7.8  | 32.5 | 44.4 | 36.9 | 36.9 | 48.5 | 59    | 77.7 | 37.2                  |
| Total   | 74.8 | 44.2 | 64.1 | 60.1 | 62.2 | 81   | 67.9 | 100.1 | 101  | 56.8                  |

Source: IMF Country Report No. 05/31 Kyrgyz Republic: Statistical Appendix, February 2005.

The gap between the Kyrgyz and Chinese statistics implies the existence of shuttle trade with huge turnovers.<sup>53</sup> Nevertheless, there has also been growth in official trade turnover. The Intergovernmental Kyrgyz-Chinese Commission on Trade and Economic Cooperation in 1994 opened the way for trade across the Chinese-Kyrgyz border. However, it was not until 1998 and 1999 that the commission started to address the bottlenecks in cross-border trade and investments. In 1999, the parties agreed to rehabilitate roads, in particular the Osh-Sary-Tash-Irkeshtam road and such cargo and passenger routes as Osh-Kashgar-Osh and Osh-Artush-Osh.<sup>54</sup> At the sixth session of the commission in Beijing in 2004 it was agreed that Sinopec's subsidiary, Shenli Oil Company, would participate in developing Kyrgyzstan's Alai Hollow oil fields.<sup>55</sup> Due to a lack of investments, however, many planned projects have not been realized, among them \$1 billion railroad line between Osh, Turugart and Kashgar.

Kyrgyzstan's WTO membership has resulted in a trade deficit with China. In 2002, China exported goods to a value of roughly \$146 million and imported less than \$55 million from Kyrgyzstan (Appendix 1). Kyrgyz authorities confirm the trade deficit but downscale it to \$20 million (Table 1).<sup>56</sup> Compared with other players in the region, however, China's trade with

<sup>53</sup> For similar assertions see also, Paramonov, "China and Central Asia," 2005.

<sup>54</sup> Intergovernmental Kyrgyz-Chinese Commission on Trade and Economic Cooperation, Website: <<http://www.mvtp.kg/main.php?lang=en&p=7.21>> (accessed March 24, 2006).

<sup>55</sup> *UPI Energy Watch*, June 24 2004.

<sup>56</sup> In 2003 Chinese exports to Kyrgyzstan were primarily in textiles, staple fibres, footwear, plastic and machinery, while Kyrgyzstan exported primarily aluminium, iron, steel, copper, hides and skins. Chinese Customs Statistics, 2003, from Hsiu-Ling

Kyrgyzstan is however small: Kyrgyz-Russian trade stands at \$273,1 million, while Kyrgyzstan – Kazakhstan trade is \$228 million.<sup>57</sup>

### *China and Tajikistan*

Civil war between 1992 and 1997, the weakness of the state, and drug trafficking have created a huge illicit economy in Tajikistan. By contrast, bilateral trade with China was modest down to 2003, where it increased a significant 206.8 percent, from \$12,386 million to \$38 million (Appendix 1).<sup>58</sup> These official Chinese figures, however, are about four times higher than IMF estimates.<sup>59</sup> The difference may be attributable to the extensive shuttle trade that arose with the opening of the Chinese-Tajik border in 2004.<sup>60</sup>

Xinjiang has built a new road to Tajikistan and Chinese specialists are participating in the rehabilitation of the Duhambe-Nurobod-Jirgoatol-Kyrgyz border highway, as well as the construction of the Tajik highway tunnels “Sharshar” and “Shahriston.”<sup>61</sup> The United States is financing and building a bridge over the Panj River, linking Tajikistan with Afghanistan, which will facilitate trade to the south. This will also give China an opportunity to transport goods through Afghanistan onward to destinations further south. Nevertheless, much work remains before the Tajik infrastructure is competitive. Typical is the still primitive Kulyab-Khorog highway section in

Wu & Chien-Hsun Chen, 2004, “The Prospects for Regional Economic Integration between China and the Five Central Asian Countries,” *Europe-Asia Studies* 56, 7 (November 2004)

<sup>57</sup> IMF Country Report No. 05/31, February 2005, Kyrgyz Republic: Statistical Appendix, Table 21. Kyrgyz Republic: Direction of Trade, 1995-2004.

<sup>58</sup> The goods traded in the bilateral official economy in 2002 were primarily aluminium, iron, steel and cotton exported to China, while Tajikistan imported home appliances, electrical machinery, woven apparel, footwear, and food. Chinese Customs Statistics, 2003, from Hsiu-Ling Wu & Chien-Hsun Chen, 2004.

<sup>59</sup> Paramonov, ‘China and Central Asia,’ May 2005, p. 6.

<sup>60</sup> Zafar Abdullaev and Lydia Isamova, “Tajikistan looks to the East,” *RCA* No.303, July 27 2004.

<sup>61</sup> Welcoming address by Tajik Prime Minister Akil Akilov at the First Preparatory Conference to the Fourteenth OSCE Economic Forum, Dushanbe, Tajikistan, November 7-8, 2005.

the south of the country, which is an essential part of the route to China.<sup>62</sup> Nor is Chinese infrastructure ready for trade. The south-western region is the poorest in Xinjiang, which is forcing China to invest heavily in infrastructure development there.<sup>63</sup>

Although the Tajik economy is oriented mainly to Russia and Uzbekistan with a total trade turnover of \$394 and \$235, respectively,<sup>64</sup> the Sino-Tajik economic ties have strengthened significantly with the opening in 2004 of the Kulma Pass linking China and Tajikistan. China's and Tajikistan's interest in a functioning transport corridor has resulted in several further projects, including collaborations in telecommunication and communication services.

### *China and Turkmenistan*

Until recently, economic ties between China and Turkmenistan were limited. According to Chinese Customs Statistics, the total trade turnover amounted to \$32.7 million in 2001, but by 2005 had topped \$100 million. The Turkmen trade deficit is substantial, until its exports to China accounted for no more than \$735,000 as recently as 2002.<sup>65</sup>

Energy cooperation over the Turkmenistan-Afghanistan-Pakistan-Indian pipeline could, if realized, be a ground-breaking event. The April 2006 visit of President Niyazov to Beijing promises to change this situation radically. While details remain unclear as of this writing, China has signaled its interest to import gas from Turkmenistan via Kazakhstan. Chinese firms may also invest in the proposed TAP or TAPI (Turkmenistan-Afghanistan-Pakistan/India) pipeline from the Dauletabad-Donmez gas field in Turkmenistan through Afghanistan to the Pakistani port of Gwadar, with a

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<sup>62</sup> *Ibid.*; this section of the highway is presently being upgraded by Turkish companies, however it is estimated that rehabilitation will take years.

<sup>63</sup> Yueyao Zhao, "Pivot or Periphery? Xinjiang's Regional Development," *Asian Ethnicity* 2, 2 (2001): 217.

<sup>64</sup> IMF Country Report No. 05/31, February 2005, Kyrgyz Republic: Statistical Appendix, Table 21. Kyrgyz Republic: Direction of Trade, 1995-2004.

<sup>65</sup> *Chinese Customs Statistics*, 2003. These exports were mainly made up of plastic, silk, and yarn.

possible extension to India.<sup>66</sup> Both China and Russia have been competing for influence and put themselves forward as possible funders.<sup>67</sup> Due to Turkmen President Niyazov's unfavorable reputation among foreign investors, the situation in Afghanistan, as well as the animosity between India and Pakistan, it long remained unclear whether and when the pipeline will be built. It remains to be seen if his death in December, 2006, will change the situation

### *China and Afghanistan*

Since the fall of the Taliban regime, China has shown interest in the reconstruction of Afghanistan, even though Chinese assistance thus far has been extremely limited; a stable Afghanistan integrated into the regional economy is certainly in the interest of China.<sup>68</sup> At the recent Afghanistan Compact Conference in London, China promised a total of US\$10 million in 2006, and agreed to abolish tariffs on Afghanistan exports to China.<sup>69</sup>

The increasing engagement of China in Afghanistan is also discernible in the volume of bilateral trade (Table 2). Beginning in 2003–04, China has established itself as the main exporter to Afghanistan. Afghan imports from China have increased from 2 percent in 2001–02, and 1 percent in 2002–03 to 18 percent of the total in 2005–06, according to IMF statistics provided by Afghan authorities. Afghan sources claim that this amount represented a total import of \$385 million.<sup>70</sup> Chinese Customs Statistics estimate that the total trade volume was \$58 million in 2004, which fell to \$48 million in 2005.<sup>71</sup>

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<sup>66</sup> "Poor prospects for Transafghan Gas Line," *Stratfor*, December 26 2002.

<sup>67</sup> Starr, "China's Reemerging Transport Network," 2005.

<sup>68</sup> "Special envoy of China on Afghanistan Reconstruction," *People's Daily*, January 23 2002.

<sup>69</sup> "China pledges nearly \$10m in aid to Afghanistan in 2006," The Chinese Government's Official Web Portal, 1 February, 2006, [http://www.gov.cn/misc/2006-02/01/content\\_176548.htm](http://www.gov.cn/misc/2006-02/01/content_176548.htm), (accessed 30 January 2007).

<sup>70</sup> IMF Country Report No. 06/114 March 2006 Islamic Republic of Afghanistan: Selected Issues and Statistical Appendix Table 40. Islamic Republic of Afghanistan: Direction of Trade, 2001/02–2005/06, March 2006, [www.imf.org/external/pubs/ft/scr/2006/cr06114.pdf](http://www.imf.org/external/pubs/ft/scr/2006/cr06114.pdf) (accessed 30 January 2007).

<sup>71</sup> Xinhua's China Economic Information Service, Feb 6 2006.

Table 2. Afghanistan: Direction of Trade 2001–02/2005–06

|                | 2001–02 | 2002–03 | 2003–04 | 2004–05 | 2005–06 |
|----------------|---------|---------|---------|---------|---------|
| <u>Exports</u> | 100     | 100     | 100     | 100     | 100     |
| Pakistan       | 39      | 26      | 69      | 85      | 85      |
| India          | 15      | 27      | 8       | 7       | 7       |
| Other          | 46      | 47      | 23      | 8       | 8       |
| <u>Imports</u> | 100     | 100     | 100     | 100     | 100     |
| Pakistan       | 9       | 8       | 9       | 15      | 15      |
| Japan          | 35      | 41      | 14      | 16      | 16      |
| China          | 2       | 1       | 18      | 18      | 18      |
| Other          | 54      | 50      | 59      | 51      | 51      |

Source: IMF Country Report No. 06/114 March 2006 Islamic Republic of Afghanistan: Selected Issues and Statistical Appendix.

Chinese companies have also shown some interest in investing in Afghanistan, although there is significant undeveloped potential even here. In 2003, for instance, a Chinese trading firm China Merchandise Trade Center Ltd opened an office in Kabul, marketing approximately 1,000 Chinese wholesale products.<sup>72</sup> According to President Karzai, some 100 Afghan businessmen also went to China that same year.<sup>73</sup> Chinese companies ZTE and Huawei are partnering with the Afghan Ministry of Communications to implement digital telephone switches and are providing roughly 200,000 subscriber lines.<sup>74</sup> China has taken part in the reconstruction of Afghanistan's infrastructure by participating in the Parwan irrigation project, restoring water supply in Parwar province, as well as the reconstruction of the public hospital in Kabul.<sup>75</sup> The U.S. has also hired Chinese firms for various construction projects in Afghanistan.

### *Afghanistan and Pakistan*

Pakistan is by far Afghanistan's most important trading partner in Greater Central Asia. Today, 85 percent of Afghanistan's exports are sent to

<sup>72</sup> "First Chinese trade firm opens in Afghan Capital," *People's Daily*, 30 July, 2003.

<sup>73</sup> "Karzai: Deem neighbourhood with China an Honour," *People's Daily*, 16 July, 2004.

<sup>74</sup> Ministry of Communications, Islamic Republic of Afghanistan. website:

<<http://www.moc.gov.af/vendors.asp>> (accessed 28 March, 2006).

<sup>75</sup> The Economic and Commercial Counsellor's Office of the Embassy of the PRC in Afghanistan, Communique of Vice President Zeng Qinghong's talks with Afghan Vice President Nimartullah Sharani, 28 November, 2004.

Pakistan, while Pakistani exports to Afghanistan represent 15 percent of Afghan total imports. This strong bilateral trade results primarily from the improved political situation in Afghanistan, macro-economic stabilization in Pakistan, and a surge of Pakistani investment in Afghanistan.<sup>76</sup>

Although this development is favorable for the Afghan economy, Afghanistan would be well advised to reduce its export dependency on Pakistan by forging stronger ties with other states in the region.<sup>77</sup> The current dependence on Pakistan leaves Afghanistan vulnerable to exogenous shocks.<sup>78</sup> By opening up its north/northwest corridors through improvements in infrastructure, Afghanistan has the potential to become the center of regional and continental trade and an important transit point on both the east/west and the north/south routes.<sup>79</sup>

Here, China could play an even more important role. The Chinese project of linking the Gwadar port in the Arabian Sea to Xinjiang via both Pakistan and Afghanistan/Tajikistan will intensify Afghanistan's trade, as will the proposed project of a highway from Gwadar to Kandahar and Islamabad.<sup>80</sup> These routes will make it possible for Chinese goods to transit Afghanistan on their way to Gwadar.

### **Impediments to China's Active Involvement with Continental Trade Involving Greater Central Asia**

Despite these impressive developments in Sino-Greater Central Asian economic integration, several important impediments to further cooperation remain. These impediments could compromise the revival of the open economic space that once existed between the Central Asian states.

The single most important impediments are bureaucratic delays at borders and costs caused by demands for unofficial payments. Transport from

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<sup>76</sup> Starr, "Central Asia's Reemerging Transport Network," 2005, p. 6.

<sup>77</sup> IMF Country Report No. 06/114 March 2006 Islamic Republic of Afghanistan: Selected Issues and Statistical Appendix Table 40. Islamic Republic of Afghanistan: Direction of Trade, 2001/02–2005/06

<sup>78</sup> Ibid.

<sup>79</sup> Starr, "Central Asia's Reemerging Transport Network," 2005, p.3.

<sup>80</sup> Ibid, p.2.

Xinjiang through Central Asia entails delays, uncertainty, unofficial payments, legal perplexity, and a number of other problems.<sup>81</sup> A recent survey of continental truck drivers passing through the Greater Central Asia region was revealing: almost none cited security or corruption as a major concern, while only one-third cited poor roads as impediments to trade. However, 96 percent of them pointed to lengthy waits at customs as the main impediment to trade.<sup>82</sup> Reducing border inefficiency and slow waits is the *sine qua non* for expanding continental trade.

Xinjiang and Greater Central Asia will suffer from high transport costs to world markets due to their land-locked locations. But transport times are quite a different matter, however.<sup>83</sup> High transport costs to and from the region can be partly mitigated by low production costs, but long transport times cannot. As stated by Lucke and Rothert, “Long transport times are likely to be an obstacle to trade development quite apart from direct *transport costs* (...) As participation in production networks requires just-in-time deliveries of goods along the production chain, long (and presumably variable) transport times render it more difficult for Central Asian firms to initiate non-traditional exports by participating in production networks.”<sup>84</sup> This has important implications for the formulation of a strategy on infrastructural problems in Central Asia. Haulers waiting at borders generate expense through wages and inoperative trucks. Arbitrary and unpredictable transport times can disrupt an entire production chain. A quantitative

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<sup>81</sup> Martha Blaxall, presentation at Forum “China’s Emergence in Central Asia; Security, Diplomacy and Economic Interests: Energy and Trade in China-Central Asian relations,” Washington DC, CSIS, 22 April, 2003.

<sup>82</sup> See Nicklas Norling, “First Kabul Conference on Partnership, Trade and Development in Greater Central Asia,” Central Asia-Caucasus Institute and Silk Road Studies Program, Washington, DC, 2006, p.6.

<sup>83</sup> It has been estimated that transport costs in Central Asia amount to as much as 60 percent of the value of manufactured imports. See Statement by H.E. Mrs. Madilna B. Jarbussynova, Ambassador Permanent Representative of Republic of Kazakhstan to the United Nations, Agenda item 92 (a), New York, 26 October, 2000, [www.un.int/kazakhstan/s\\_261000.htm](http://www.un.int/kazakhstan/s_261000.htm) (accessed on 30 January 2007)

<sup>84</sup> Matthias Lucke and Jacek Rothert, “Comparative Advantage in International Trade for Central Asia,” Paper commissioned for ADB, Kiel Institute of World Economics, January 2006, p. 11 <  
[http://siteresources.worldbank.org/INTTRADERESEAR/RESOURCES/Luecke\\_Rothert-Comp\\_Adv\\_Central\\_Asia-Jan2006.pdf](http://siteresources.worldbank.org/INTTRADERESEAR/RESOURCES/Luecke_Rothert-Comp_Adv_Central_Asia-Jan2006.pdf)> (accessed on 31 January 2007).

assessment made by the OECD of the different effects of direct (e.g., extensive documentation requirements) and indirect (e.g., slow waits) trade transactional costs argues that reducing waiting times at borders has a more marked effect than the reduction of documentation requirements.<sup>85</sup> To boost competitiveness, the Greater Central Asia states and Xinjiang should attack this problem by developing a functioning logistics network and improving border efficiency, rather than by subsidizing transport operators in order to lower transport charges.

### *Rail Transport (China-Kazakhstan)*

Presently, railroads carry 75 percent of all trade between China and the Central Asian republics. However, the Druzhba-Ala pass is increasingly becoming a bottleneck and the differences in gauge-width between China and Kazakhstan delay cargo significantly. The problem is worst on the Kazakh side, in Ala, where cargo has to be manually off-loaded and transferred to Chinese train cars. The situation on the Chinese side, in Druzhba, is markedly better where Chinese trains go through a retrofit of wheels that adjusts them to the Kazakh system.<sup>86</sup> Incoming goods from Kazakhstan now include raw materials and other bulky items, while Chinese exports are low- bulk manufactures. This results in shortage of Chinese railcars from the border to Urumchi and lengthy waits estimated to be 3–5 days for cargo at borders.<sup>87</sup> This of course is part of a broader problem caused by China's overall trade imbalance. This is especially so in sea-borne transports, where ships are forced to return empty on their back-haul from America and Europe.<sup>88</sup>

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<sup>85</sup> OECD, *Quantitative Assessment of the Benefits of Trade Facilitation*, 2003, p.4.

<sup>86</sup> *Ibid*, p. 38.

<sup>87</sup> *Ibid*, p. 38.

<sup>88</sup> Thomas Fuller, "China trade unbalances shipping," *International Herald Tribune*, January 30, 2006.

*Road Transport (China-Kazakhstan)*

Due to bottlenecks in rail transport, road transport has become increasingly popular, not least because of the greater flexibility in distribution it allows. The road through Horgos is becoming a more viable option and will relieve pressure on the Druzhba-Ala pass. China has begun to rehabilitate the Jinhezhi-Yining-Horgos route, and this alternative route will reduce the distance between Urumchi and Almaty by 200km.<sup>89</sup> As with Druzhba-Ala, there is a significant trade-imbalance at Horgos with trucks rolling full en route to the Kazakh border but returning empty.<sup>90</sup> Overall, rail transport, if available, would be the preferred alternative as it is cheaper, safer, and more certain.<sup>91</sup> As China is not yet a signatory to the TIR convention, trucks from China and Xinjiang cannot enter Kazakhstan. Although an exemption is made for trucks accessing border trading zones in Kazakhstan, and though trucks may access Almaty from Xinjiang, they cannot go as far as Astana. Instead, trucks usually stop at the border, where goods are unloaded while waiting for permission to travel into foreign territory. This imposes high transaction costs, as cargo may be delayed up to half a month at the border.<sup>92</sup>

The impact of poor infrastructure is even more severe in the energy sector. The lack of a regional energy strategy not only prevents economies of scale through pooled investments but also increases costs in transporting energy outside of the region. For example, the export of gas-generated electricity from Turkmenistan and Uzbekistan to Herat and the north of Afghanistan is conducted over Soviet-era lines, while Kyrgyz electricity destined for Xinjiang is limited due to inadequate electric transmission lines.<sup>93</sup> In all the new Atasu-Alashankou pipeline connecting China with Kazakhstan is a major boost, but more work remains. Participating countries have to date depended on their own limited solutions, pursuing their few cooperative measures bilaterally only rather than multilaterally. Meanwhile, the business

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<sup>89</sup> ADB, *Xinjiang Autonomos Region*, 2005, p. 33-34.

<sup>90</sup> *Ibid*, p. 46.

<sup>91</sup> *Ibid*, p. 33.

<sup>92</sup> Eva Molnar and Lauri Ojala, *Transport and Trade Facilitation Issues in the CIS-7, Kazakhtan, and Turkmenistan*, The paper was prepared for the Lucerne Conference of the CIS-7 Initiative, 20th-22nd January 2003.

<sup>93</sup> Starr, "Central Asia's Reemerging Transport Network," 2005, p.3.

sector has been developing cooperative energy projects without clear policy direction at the governmental level.<sup>94</sup> The obvious step towards improving energy cooperation between Tajikistan and Afghanistan is the restoration of the electricity exporting capacity to 100 kV from 35 kV, which the U.S. is now undertaking. But even this is a rare exception.

### **Infrastructure within Greater Central Asia**

The failure of Central Asian states to integrate their infrastructures with neighbouring countries is due both to political mistrust and the lack of financing. Politics intervened when Kazakhstan built the Kuzylasker-Kirovskii road from the Chardara Reservoir in the south; it was not connected with Uzbekistan as would have made sense geographically. Similarly, Kyrgyzstan, made a \$12 million upgrade of the Jalal-Abad to Uzgen road in order to avoid passing through Uzbekistan, and Turkmenistan has avoided linking Uzbekistan into its new rail line connecting Kerkishi and the Amu Darya valley. Uzbekistan, in turn, has responded by excluding Turkmenistan from its \$10 million Uchkuduk-Misken-Karauzak rail line connecting Bukhara with Nukus via Navoi. While these improvements of national infrastructure certainly have benefited domestic movement of goods and people, they hamper the possibilities of regional trade and entrench a system of continued border rigidity.<sup>95</sup>

The problem of poor infrastructure is exemplified by the link between Osh and Bishkek in Kyrgyzstan and Dushanbe and Khorog in Tajikistan. Other key infrastructure is simply non-existent. As stated by Kydykbek Isaev, Director General of the Kyrgyz Railways National Company, "The railway system of Kyrgyzstan is divided into two parts—northern and southern. The absence of reliable contacts between the two economically developed regions of the country creates a number of economic, social, and political problems."<sup>96</sup>

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<sup>94</sup> Kim Hyun-Jae & Shim Sang-Yul, "Operation and Support of the SOM and Conference for Energy Cooperation in Northeast Asia," *KEEI* (March 2004): 3.

<sup>95</sup> UNDP, Central Asia Human Development Report, 2005, p. 61.

<sup>96</sup> "Numbers of Chinese companies are united and ready to participate in construction of railway China-Kyrgyzstan-Uzbekistan," *Kabar*, December 29 2005.

The mountainous nature of the region also affects prospects for a regional economy and the equal distribution of trade gains. To include remote mountain areas, there is a need to build costly secondary roads, communication systems, and access to new highway systems. Only then will rural and mountainous areas have a chance of survival as economic integration goes forward.<sup>97</sup> If not, backwardness and underdevelopment is a natural consequence, and that is why regional cooperation, the building of infrastructure, and the reduction of trade barriers is even more important in mountainous zones than in coastal areas.<sup>98</sup> Moreover, there are few trans-regional transportation systems such as buses and trains. This impacts the flow of merchandise and people to and from the region and reduces prospects of business interaction across regions. To be sure there has been some progress, for example, the new bus links between Tajikistan and Kashgar in western China and the new bus services between China and Pakistan, but much remains to be done.<sup>99</sup>

There is also a need to integrate Afghanistan into the regional network. The construction of the Dushanbe–Kurgonteppe–Kolkhozobod–Nizhny-Panj railway line with an exit to Afghanistan and the ADB-proposed rehabilitation of the Uzbek-Afghan rail link are two of many projects with obvious potential for such integration.<sup>100</sup>

There is also lack of cooperation between local banks and those foreign banks that could assist Central Asian traders in China.<sup>101</sup> By contrast, Chinese traders in Central Asia have received support from their national banking system and trade offices. Chinese trade offices have opened in all five Central Asian states, while the Bank of China and the Industrial and Commercial Bank of China have representatives in Kazakhstan.

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<sup>97</sup> Starr, "Central Asia's Reemerging Transport Network," 2005, p.10.

<sup>98</sup> Paramonov, "China and Central Asia," 2005, p.10.

<sup>99</sup> Zafar Abdullaev and Lydia Isamova, "Tajikistan looks to the East," *RCA*, No. 303, July 27 2004.

<sup>100</sup> CAREC, Central Asia Regional Economic Cooperation Member Countries: Regional Cooperation Strategy and Program, 2005-2007.

<sup>101</sup> Martin Spechler, 2003, p.278.

Security impediments to China's deeper engagement in Greater Central Asia and continental trade have two dimensions: first, the direct threats to Chinese citizens, entrepreneurs, and construction workers in Pakistan and Greater Central Asia; and the more overarching security threats of drug-trafficking, terrorism, and cross-border criminality. Although both of these may impede the expansion of regional and continental trade, they do not impede trade to the extent often claimed, nor do they put any significant brakes on Beijing's expansion into the region. In fact, the causation may be reversed, as increased economic interaction inadvertently gives rise to a safer and more stable security environment. Nonetheless, Chinese concern over separatism and over unstable socio-political climate in Central Asia have moderated Beijing's determination to boost trans-border trade and investment initiatives.

One of the foremost concerns for Beijing is the fear that the weak Central Asian states could provide safe-havens for various kinds of criminal groups. The Chinese point in particular to the Semirechye region in Kazakhstan, the Ferghana valley in Uzbekistan, Osh in Kyrgyzstan, and Khojent in Tajikistan. Worse, China believes that these areas are home to groups affiliated with Xinjiang's separatist movements.<sup>102</sup> The almost unchecked drug economy in Afghanistan, and Tajikistan also affects China's willingness to decrease border controls and increase cross-border trade.<sup>103</sup>

Attacks on Chinese workers in Pakistan and Afghanistan have to some extent also affected Chinese engagement in these countries. In February 2006, the Balochistan Liberation Army (BLA) killed three Chinese workers and their driver in southern Pakistan just prior to Pakistani President Musharraf's state visit to China.<sup>104</sup> Chinese workers in Gwadar have been targeted occasionally as well,<sup>105</sup> restoration work on the Karakorum Highway has also been negatively affected by terrorist activities and cross-border

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<sup>102</sup> Xu Tao, "Central Asian Countries' Security Strategies and China's Western Border Security", *Strategy and Management*, No.5, 2006

<sup>103</sup> Xing Guangcheng, "Security Cooperation in Central Asia", *Contemporary World, Iss.* 282, 2005.

<sup>104</sup> "Pakistan: Chinese Workers Shot Dead," *Stratfor Situation Reports*, February 15 2006.

<sup>105</sup> See for instance B. Raman's account of "The Blast in Gwadar," *South Asia Analysis Group* paper No. 993, 8 May 2004.

crimes.<sup>106</sup> Further the slaying of eleven Chinese workers near the Northern Afghan city of Kunduz in 2004 provoked a strong Chinese reaction.<sup>107</sup> The recently proposed pipeline running from Gwadar to Xinjiang, as well as Iranian energy supplies transiting Baluchistan by road are both impeded by separatist activity in the Pakistani region province of Baluchistan.<sup>108</sup>

All in all, security concerns serve as a caution flag as Beijing expands trade with Greater Central Asia and Pakistan.<sup>109</sup> Yet of the impediments affecting trade, security should not be over-estimated as a factor determining trade policies, for Beijing realizes that increased trade with its neighbors will alleviate the security situation in the long term.

Even though some improvements have been seen in the political climate, especially in Kazakhstan and Afghanistan, further efforts are needed. Uzbekistan's strict control over foreign investments have all but killed major investments.<sup>110</sup> Corruption is a further reason cited by foreign investors for staying out of the region.<sup>111</sup> The weak legal frameworks of the Central Asian countries are another major impediment to investments and economic development. As countries become independent, judicial remedies become inaccessible in many situations. These factors made the Central Asian region less competitive and unattractive for foreign investors, while simultaneously fostering corruption and abuse of the legal system. Central Asia is still suffering from turbulence in its legal systems.<sup>112</sup>

Protectionism represents a further brake on cooperation and integration. This varies from high protective tariffs in Uzbekistan, with lower tariffs in

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<sup>106</sup> "Sino-Pak. Energy Corridor: A Tentative Analysis of Feasibility", *Economic Times* (China), 2 March, 2006

<sup>107</sup> See for example, "Attack on Chinese Workers in Afghanistan Condemned," *People's Daily*, 11 June, 2004.

<sup>108</sup> B. Raman, "Chinese Presence in Balochistan & Northern Areas," *South Asia Analysis Group* Paper no. 1809, 2006.

<sup>109</sup> Ji Fangtong & Zhu Xinguang, "Central Asian Non-traditional Security Cooperation in Post-Cold War Scenario", *World Economics and Politics*, No. 5, 2004

<sup>110</sup> Hsiu-Ling Wu & Chien-Hsun Chen, "The Prospects for Regional Economic Integration," 2004, p. 1074.

<sup>111</sup> UNDP, Central Asia Human Development Report, 2005, p. 63.

<sup>112</sup> Hsiu-Ling Wu & Chien-Hsun Chen, "The Prospects for Regional Economic Integration," 2004, p.1076.

Kazakhstan, and lower ones still in Kyrgyzstan and Tajikistan. Protectionist trade policies have effectively prevented a return to the old intra-regional trade patterns that previously united the extended region. Wherever it exists, protectionism raises the real exchange rate, levying a heavy burden on companies, which they pass along in the form of higher prices.<sup>113</sup>

In addition, border disputes can interrupt water flows and energy supplies, sowing uncertainty among farmers and villagers who need predictable supplies of both.<sup>114</sup> The failure to meet these challenges is partly rooted in the lack of effective region-wide cooperative structures in Greater Central Asia. This is due in part to fears that Uzbekistan aspires to become a potential regional hegemon.<sup>115</sup>

Unfortunately, some of the trading agreements that have been reached in the region have adversely affected the regional economy. Apart from the fact that the initiatives of the CIS, EURASEC, SES, and ECO remain toothless abstraction, their full implementation could have destructive consequences for some countries. A recent study by the ADB suggests that Kazakhstan, Kyrgyzstan, and Tajikistan are particularly vulnerable if the EURASEC customs union would be implemented, due to its effect on extra-regional trade. For Kazakhstan the cumulative shortfall would reach almost \$10 billion, translating into a GDP that is 20.8 percent less by 2015, compared with the baseline scenario.<sup>116</sup> The report concludes: “We found that implementing the customs union, even with a reduction in Kazakhstan’s external tariffs, would cause substantial trade diversion and slow down real GDP growth compared with the baseline scenario. Implementing the [EURASEC] customs union is likely to have even greater adverse

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<sup>113</sup> Richard G. Lipsey, Peter O. Steiner, and Douglas D. Purvis, “The Gains From Trade,” Chapter 40 in *Economics* 7 ed. (New York: Harper & Row Publishers, 1984).

<sup>114</sup> “Regional co-op key to Central Asian Integration,” *China Daily*, 6 February, 2006.

<sup>115</sup> Richard Pomfret, “Trade policies in Central Asia after EU enlargement and before Russian WTO accession: regionalism and integration into the world economy”, *Economic Systems* 29 (2005); Niklas L. P. Swanström, *Regional Cooperation and Conflict Management: Lessons from the Pacific Rim* (Department of Peace and Conflict Research: Uppsala University, 2002).

<sup>116</sup> Dowling and Wignaraja, “Mapping Future Prospects to 2015,” p. 43.

macroeconomic effects on the Kyrgyz Republic and Tajikistan than in Kazakhstan.”<sup>117</sup>

These various impediments will have adverse long-term effects on Central Asia’s development in other sectors. If the present trend continues, with Central Asia serving mainly as a natural resource base for China and Russia, it will erode the region’s processing industries and drain capital. China will supply cheap manufactures to the detriment of Central Asia’s long-term human-resource and capacity development. This suggests that China will eventually have to actively promote the development of Central Asia’s human resources if it truly seeks stability and prosperity for the region. This is not needed in Central Asia only, but also in Xinjiang, where massive amounts of investment have been devoted to infrastructure, but almost none to human capital, health, or education.<sup>118</sup> Considering the high transport costs incurred on goods, an expansion of local manufacturing industries will also reduce expenditures on transport.

An example of such encouragement, but which also proves the depreciation of human capital in parts of Central Asia, is the Lishida Yarn Factory in Tajikistan. The factory was established as a joint Sino-Tajik venture at a total capitalization of \$9.74 million with the assistance of the Export-Import Bank of China. However, the firm has ceased production due to a lack of experienced Tajik managers, as well as a shortage of parts needed to repair production equipment.<sup>119</sup> Examples such as these will only increase until investments are made in Central Asian human capital.<sup>120</sup>

### **Means for Removing These Impediments and Their Estimated Costs**

Security concerns, political impediments, and human-resource needs are crucial issues for facilitating regional and continental trade, the most

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<sup>117</sup> Ibid, p. 44-45.

<sup>118</sup> OECD, *China in the Global Economy Challenges for China's Public Spending: Toward Greater Effectiveness and Equity*, March 2006, p.6, [www.oecd.org/dataoecd/18/26/36228704.pdf](http://www.oecd.org/dataoecd/18/26/36228704.pdf) (accessed 30 January 2007)

<sup>119</sup> Hsiu-Ling Wu & Chien-Hsun Chen, “The Prospects for Regional Economic Integration,” 2004, p.1074.

<sup>120</sup> Paramonov, “China and Central Asia,” May 2005, p. 12.; see also Hsiu-Ling Wu & Chien-Hsun Chen, “The Prospects for Regional Economic Integration,” 2004, p. 1061.

important step to this end is reduction of long waits at borders and the streamlining of transport times and costs. Only then can Greater Central Asia take advantage of its location at the cross-roads of major transport corridors. This suggests that urgent efforts should be devoted to reduction of these barriers. Regional initiatives such as EURASEC, ECO and SCO should be commanded, yet many of these same initiatives have actually complicated trade (i.e., the spaghetti bowl effect).<sup>121</sup>

China is currently working to join the TIR convention that will bring its road transport system with international standards. Due to the increasing significance of the Horgos border crossing in continental truck trade, it is all the more important for standards to be harmonized between China and Central Asia, and that Chinese and Kazakh trucks can enter each others country. Further expansion of the Horgos border processing will also relieve Druzhba-Ala and help balance trade flows from Central Asia. The TIR convention will speed the flow of goods from China to Europe as goods transported under the TIR convention are exempted from customs inspections. The TIR convention will also require China to stop subsidizing the transport industry in Xinjiang. This significantly distorts competition and imbalances trade flows, as bulky high-volume items from Central Asia can be transported at prices far below market costs.<sup>122</sup>

The problem with the TIR convention is that it is costly for entrepreneurs to implement it. Trucks have to meet very demanding and expensive standards and truckers need to carry insurance to cover the potential loss of TIR-transported goods. Although the cost of insurance is costly it can be offset by potential profits. New trucks that meet the Euro-class 3/5 emission requirements cost between \$70,000 and \$100,000, making them unaffordable for Central Asian firms. Still, the implementation of the TIR system is crucial if overland continental trade is to develop. A possible solution is to temporarily exempt small-sized trucking firms from emission and vehicle requirements. As truckers benefit from increasing volumes, they should be

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<sup>121</sup> See for example, UNDP, *Bringing Down Barriers*, 2005.

<sup>122</sup> ADB, *Xinjiang Autonomous Region*, November 2005, p.70.

able to afford new trucks that will fully meet TIR requirements, at which time the full TIR convention can be implemented.

For Afghanistan, Kazakhstan, Tajikistan and Uzbekistan, the most important potential trade framework is the World Trade Organization (WTO). The membership of China, India, Pakistan, and Kyrgyzstan, combined with Russia's expected accession, leaves the remaining Greater Central Asian states encircled by WTO states without preferential market access to these countries. WTO accession could expand bilateral trade significantly, while giving the benefits of most-favored nation (MFN) status. Beyond all of this, WTO membership will bring greater access to world markets.

All Greater Central Asia countries have started accession negotiations, but only Kazakhstan has made most progress. The costs of joining WTO are small and are mainly associated with the negotiation process e.g., building national institutions, preparing accession documents, as well as the actual negotiations. But WTO membership also limits policy options, such as relying on strategies of import substitution strategies. And while there should be no doubt about the potential benefits of WTO membership, without good governance these gains will go unrealized.<sup>123</sup>

China has shown interest in making infrastructure investments in Central Asia, primarily in the regions neighbouring Xinjiang and in countries with which they share major business interests. Some of the road construction projects are unlikely to be completed, like the Kashgar-Torugart-Jalalabad road, which is projected to cost over \$1 billion due to the difficult terrain.<sup>124</sup> Even with the projected trade volume of 10 million tons on this route, the project will not be financially viable. Other projects, like the construction of a new Urumchi-Horgos-Almaty line, are relatively cheap (\$300 million) and will reduce bottlenecks. Newly constructed roads or upgraded roads along the most heavily used corridors should also reduce impediments, especially on the Bishkek-Torugart and Tashkent-Bishkek-Almaty-Horgos-Urumchi

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<sup>123</sup> OECD, OECD Regional Trade Forum on Economic and Trade Implications of the WTO Accession, Almaty, June 3-4 2004. TD/TC/WP(2004)19/FINAL.

<sup>124</sup> See for example John W. Garver, "China's Development of Overland Transport Links," 2006.

roads, as well as on the Andijan-Osh-Irkeshtan route.<sup>125</sup> These international transport corridors need in turn to be linked with national transport routes to disperse the benefits to all regions of each state.

Although new roads would be of great benefit, there is also an urgent need to develop further the logistics and customs sector. Expanded warehouses at Horgos and Druzhba-Ala would help to meet the growing volume of trade, and there is an urgent need to decrease the manual handling of goods.<sup>126</sup> To increase efficiency in the logistics sector, it will be important to create a more even flow of goods across the border by reducing trade imbalances. This is best accomplished through the further development of additional main border posts, the elimination of subsidies in the transport sector, and the promotion of manufacturing and processing in Central Asia so as to reduce the high volume/low value one-way trade in raw materials.

Overall, it will be necessary to increase the current combined annual spending of approximately \$1 billion on Central Asian infrastructure. Some estimate that for Central Asia to sustain growth this figure must be raised to \$2-\$3 billion for each year down until 2010.<sup>127</sup> There is also a need to integrate Afghanistan more closely with former Soviet parts of Central Asia. These projects mainly involve the rehabilitation of existing roads, bridges, and tunnels such as the Freedom bridge linking Afghanistan at Termez in Uzbekistan and the Salang tunnel further south.<sup>128</sup>

### **Energy Cooperation**

Considering the substantial complementarities in this sector, energy cooperation has great potential for the region. There have been several attempts at bilateral and trilateral energy cooperation, and even some cases of multilateral energy cooperation such as ASEAN+3, the Shanghai

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<sup>125</sup> ADB, *The 2020 Project: Policy Support in the People's Republic of China*, Manila, 2003, p. 133.

<sup>126</sup> ADB, *Xinjiang Autonomous Region*, November 2005, p.65.

<sup>127</sup> Dowling and Wignaraja, "Mapping Future Prospects to 2015," p.36

<sup>128</sup> Frederick Starr, "Afghanistan: Free Trade and Regional Transformation," for the *Asia Society*, <[http://www.cacianalyst.org/Publications/Starr\\_Asia\\_Society\\_Afghanistan.htm?SESSION=NO](http://www.cacianalyst.org/Publications/Starr_Asia_Society_Afghanistan.htm?SESSION=NO)> (accessed 28 March, 2006).

Cooperation Organization, and the Northeast Asian Economic Forum. A serious problem with these programs to date is that they do not take into account the interests of all actors, including the national sources of natural resources, the refining points, and the transit countries for oil and gas. Successful integration needs to include all available actors in a truly multilateral forum. There have been several suggestions on how best to accomplish regional cooperation on energy issues.<sup>129</sup> But as yet there are very few actual mechanisms in the region to make such cooperation real. The geo-strategic aspect of energy greatly complicate matters, with Moscow, for example, keeping Beijing's proposals for a true "strategic partnership" in energy at arm's length.<sup>130</sup>

There are no organizations in Eurasia today that have the credibility needed to bring about such cooperation. Most states acknowledge the need for further cooperation. For example, China developed a strategy for energy security in the 1990s called the "Pan-Asian Continental Oil Bridge" that would link Japan with the Middle East by means of structures that would have been under Chinese control.<sup>131</sup> From a Chinese perspective this was seen as positive, since the regional economies would become tied with one another. Others in the region viewed this as a bold attempt by China to dominate regional markets. Doubtless, any state that controls the energy transit routes would have significant power in the region.

The picture is further complicated by the fact that major external actors would view strengthened energy cooperation on the Eurasian continent with suspicion since it would, over time, integrate participating states both economically and politically. Such a Eurasian energy bloc might decrease the political and economic influence of the European Union, Middle East states,

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<sup>129</sup> Vladimir Ivanov, "Creating a Cohesive Multilateral Framework Through a New Energy Security Initiative for Northeast Asia," *ERINA Report* 55, December 2003. <[www.erina.or.jp/En/Research/Energy/Ivanov55.pdf](http://www.erina.or.jp/En/Research/Energy/Ivanov55.pdf)> (October 30, 2005)

Vladimir Ivanov, "An Energy Community for Northeast Asia: From a Dream to Strategy," *ERINA Report* 52. (June 2003) <[www.erina.or.jp/Jp/Research/db/rep15/RS-EE/04070.pdf](http://www.erina.or.jp/Jp/Research/db/rep15/RS-EE/04070.pdf)> (October 30, 2005)

<sup>130</sup> "China dissatisfied with energy cooperation with Russia," *Interfax China*, 3 March, 2006.

<sup>131</sup> Gaye Christoffersen, *Problems & Prospects for Northeast Asian Energy Cooperation*, Paper presented at IREX, 23 March, 2000.

and, most important, the United States. If such a grand project is to succeed, it needs strong external support similar to that which was received during the formative period of the European Coal and Steel Community (ECSC) project. This will also further the interest of the Euro-Atlantic community.

It all boils down to giving both consumers and producers as many options as possible. Energy cooperation and diversified export routes could increase confidence at all levels and reduce Russia's leverage over its former dependents. The construction of the Baku-Tbilisi-Ceyhan pipeline was a landmark in this regard. The trans-Afghan pipeline (Turkmenistan-Afghanistan-Pakistan-India) could open up similar vistas, as a confidence-building measure between India and Pakistan, a symbol of normalization in Afghanistan, and a window to the south for Turkmenistan—a state now strongly subject to control from Russia. Just as the BTC pipeline would have been financially impossible without Western backing, most of the planned pipelines on the Eurasian continent have similar conditions for realization, often requiring the involvement of China, Russia or both. Though all may not be fully cost-effective, they could all have huge political pay-offs in terms of strengthened sovereignties and better mutual relations.

## **Conclusions**

The development of continental trade on the Eurasian landmass represents a true win-win situation. China is becoming an ever more important trading partner for states in the region and also for Azerbaijan, Russia, Pakistan, and Iran. If impediments are removed, China will realize its four aims in the region: the development of Xinjiang; political and regional stability; energy security; and an alternative transport corridor to Europe and South Asia. Trade facilitation would likely raise GDP in Xinjiang and the Greater Central Asian states from two to three percent, with the second Eurasian land bridge forming the backbone for this growth.

There is also unexplored bilateral trade potential between China and Greater Central Asia if a trading regime is set up with greater efficiency than the current muddle of agreements. Bilateral trade could triple in the case of Tajikistan, or double in the case of Kazakhstan. Already, the burgeoning trade is bringing considerable benefits, although much state income is lost

with the increase of shuttle trade between China and Greater Central Asia that is a result of continuing obstacles to trade. Further advances in both regional and continental trade will require that such issues as the impediments to road and rail transport at the Sino-Kazakh border and within Central Asia be addressed. Overall, the most urgent issues are the lengthy waits at borders and uncertain transport times and costs.

To remove these impediments it is recommended that China and various Central Asian countries sign and implement the TIR convention; that states of the Greater Central Asia receive help in the WTO accession process; that \$2–3 billion are invested annually in infrastructure, with a sizeable portion of this devoted to the customs and logistics sectors; and that donor countries, the private sector, and international organizations realize the potential gains of energy cooperation in Eurasia and act on that realization.

In contrast to the empty talk of a “new Great Game” in Central Asia and its immediate surroundings, the reality is that the real “game” today is in the construction of infrastructure and the ability of “players” to be as well-connected as possible across region.<sup>132</sup> The monopoly that Russia held over Central Asian and Caucasian infrastructure is waning, promising greater market-access for these countries. Pipelines as well as transport routes are increasingly bypassing Russia - for example the Baku-Tbilisi-Ceyhan pipeline, the trans-Caspian pipeline, the second Eurasian land-bridge, the bridges of the Panj River linking Tajikistan and Afghanistan, and all the other hundreds of projects proposed for the region. All these are opening new transport routes and trade outlets for the former Soviet dependents.

Most existing regional trade agreements, including the Russia-dominated Eurasec, will harm rather than facilitate trade. This agreement will effectively maintain the Central Asian states within the Russian orbit and deny them market access beyond the former Soviet borders, which this is scarcely in the best interests of the Central Asian states, let alone of their emerging trading partners in Afghanistan, India, China, Pakistan, and Turkey. Instead, adherence to the most vital international regulatory

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<sup>132</sup> Stephen Blank, “Infrastructural Policy and National Strategies in Central Asia: the Russian Example,” *Central Asian Survey* 23, 3-4 (December 2004).

frameworks (e.g., the WTO and the TIR) would give both China and the Greater Central Asian states access to preferential trading terms on the world market, as well as the possibility of transport capacities sufficient to carry their products to these markets.

### Appendix 1. Chinese Customs Statistics: Trade Between China and Central Asia (in \$1,000)

|                |                 | Kazakh-<br>stan | Uzbek-<br>istan | Kyrgyz-<br>stan | Tajik-<br>istan | Turk-<br>menistan | Total     |
|----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-------------------|-----------|
| <b>1992</b>    | Trade Volume    | 369,100         | 52,520          | 35,490          | 2,750           | 4,500             | 464,360   |
|                | China's Exports | 227,930         | 38,890          | 18,850          | 1,950           | 4,090             | 291,710   |
|                | China's Imports | 141,170         | 13,630          | 16,640          | 800             | 410               | 172,650   |
| <b>1993</b>    | Trade Volume    | 434,730         | 54,250          | 102,420         | 12,350          | 4,650             | 608,400   |
|                | China's Exports | 171,690         | 42,800          | 36,550          | 6,480           | 3,850             | 261,370   |
|                | China's Imports | 263,040         | 11,460          | 65,870          | 5,880           | 800               | 347,050   |
| <b>1994</b>    | Trade Volume    | 335,654         | 123,667         | 105,375         | 3,177           | 11,260            | 579,133   |
|                | China's Exports | 138,689         | 51,458          | 29,925          | 675             | 3,669             | 224,416   |
|                | China's Imports | 196,965         | 72,209          | 75,450          | 2,502           | 7,591             | 354,717   |
| <b>1995</b>    | Trade Volume    | 390,992         | 118,552         | 231,039         | 23,859          | 17,595            | 782,037   |
|                | China's Exports | 75,447          | 47,566          | 107,498         | 14,617          | 11,267            | 256,395   |
|                | China's Imports | 315,545         | 70,986          | 123,541         | 9,242           | 6,328             | 525,642   |
| <b>1996</b>    | Trade Volume    | 459,901         | 187,258         | 105,494         | 11,715          | 11,467            | 775,835   |
|                | China's Exports | 95,306          | 38,154          | 68,678          | 7,640           | 8,452             | 218,230   |
|                | China's Imports | 364,596         | 149,104         | 36,816          | 4,075           | 3,015             | 557,606   |
| <b>1997</b>    | Trade Volume    | 527,410         | 202,916         | 106,622         | 20,227          | 15,240            | 872,415   |
|                | China's Exports | 94,628          | 61,528          | 70,601          | 11,045          | 11,633            | 249,435   |
|                | China's Imports | 432,782         | 141,388         | 36,021          | 9,182           | 3,606             | 622,979   |
| <b>1998</b>    | Trade Volume    | 635,537         | 90,245          | 198,099         | 19,229          | 12,516            | 955,626   |
|                | China's Exports | 204,681         | 57,833          | 172,406         | 11,042          | 10,293            | 456,305   |
|                | China's Imports | 430,856         | 32,362          | 25,692          | 8,187           | 2,223             | 499,320   |
| <b>1999</b>    | Trade Volume    | 1,138,779       | 40,336          | 134,871         | 8,041           | 9,491             | 1,331,518 |
|                | China's Exports | 494,375         | 27,388          | 102,899         | 2,298           | 7,468             | 634,428   |
|                | China's Imports | 644,404         | 12,948          | 31,972          | 5,743           | 2,023             | 697,090   |
| <b>2000</b>    | Trade Volume    | 1,556,958       | 51,465          | 177,611         | 17,170          | 16,159            | 1,819,363 |
|                | China's Exports | 598,749         | 39,432          | 110,174         | 6,793           | 12,102            | 767,250   |
|                | China's Imports | 958,209         | 12,033          | 67,437          | 10,377          | 4,057             | 1,052,113 |
| <b>2001</b>    | Trade Volume    | 1,288,369       | 58,301          | 118,859         | 10,760          | 32,712            | 1,509,001 |
|                | China's Exports | 327,719         | 50,684          | 76,639          | 5,308           | 31,488            | 491,838   |
|                | China's Imports | 960,651         | 7,617           | 42,221          | 5,452           | 1,224             | 1,017,165 |
| <b>2002</b>    | Trade Volume    | 1,954,742       | 131,777         | 201,874         | 12,386          | 87,515            | 2,388,294 |
|                | China's Exports | 600,097         | 104,374         | 146,156         | 6,501           | 86,780            | 943,908   |
|                | China's Imports | 1,354,645       | 27,403          | 55,718          | 5,886           | 735               | 1,444,387 |
| <b>2003*</b>   | Trade Volume    | 3,300,000       | 346,000         | 317,000         | 38,000          | 99,000            | 4,100,000 |
| <b>2004**</b>  | Trade Volume    | 4,493,305       | 575,174         | 602,207         | N/A             | 98,680            | 5,769,366 |
| <b>2005***</b> | Trade Volume    | 6,117,294       | 627,899         | 838,692         | N/A             | 100,863           | 7,684,748 |

Sources: 1992–2002 Chinese Customs Statistics, 2003 (corrected version from Hsiu-Ling Wu & Chien-Hsun Chen 2004; 2003\* Xinhua (from Paramonov, 2005); 2004\*\* Xinhua's China Economic Information Service, February 7, 2006, based on Chinese Customs Statistics; 2005\*\*\* Xinhua's China Economic Information Service, February 7, 2006, based on Chinese Customs Statistics (Note: only January–November 2005).

