COMPARATIVE ANALYSIS OF THE INVESTMENT POLICY OF RUSSIA AND CHINA IN CENTRAL ASIA (2009-2020)

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Abstract

This article explores the main drivers and determinants of Russian and Chinese foreign direct investment in Central Asia, aiming to explore potential areas for economic cooperation and possible causes of conflict between the two powers in the region.

Keywords

Foreign direct investment, OLI concept, Russia, China, developing countries.

INTRODUCTION

Further development of economic ties between China and Russia in Central Asia has been troubling experts and scholars in global economics and politics since the beginning of the 21st century. While one group of experts argued that the rise of China as a major economic player in Central Asia was likely to cause conflict with Russia in the region, other experts considered this idea exaggerated due to the complementary interests of both states in the economic development of Central Asia.

This article is aimed at studying the interaction of China and Russia with the states of Central Asia. It offers a comprehensive analysis of the main drivers and factors behind foreign direct investment (FDI) from both countries. In doing so, this article uses an analytical framework based on Dunning's FDI theory to explore the question of which driving forces and determinants explain Russian and Chinese FDI in Central Asia.

The study uses both quantitative data on FDI flows and accumulation from Russia and China and data on export to the five Central Asian republics between 2009 and 2020, as well as a qualitative analysis of the development trajectories of financial regulation, bilateral investment transactions, economic and political initiatives in the region. Thus, the article uses data from such databases as ITC Investment Map, WITS (World Bank) and DOTS (IMF), as well as data provided by regional organizations and national statistical agencies of Central Asian states.

This article consists of two parts, the first of which constitutes an analytical framework on the drivers and determinants of FDI in emerging economies based on the OLI model. The second part of the study is divided into three sub-sections: two of them are case studies providing comprehensive reports on the Russian and Chinese driving forces as well as the determinants of FDI in Central Asia. The third subsection compares Russian and Chinese FDI in the region.

THEORETICAL CONCEPT OF THE DRIVERS AND DETERMINANTS OF FDI

The two main inextricably linked questions related to FDI concern the following aspects:

- why firms engage in FDI (compared to other internationalization options such as export, licensing or activity in the domestic market only)
- why firms choose certain locations for their FDI. The OLI concept assumes that FDI can be explained by three categories of factors: ownership (O), location (L) and internalization (I) advantages.

Given the article focus on the reasons why Russia and China seek to carry out FDI in Central Asia, this study examines the «L» element of the eclectic OLI paradigm. The OLI theory points to three main motives for FDI: FDI to explore markets, FDI to improve efficiency (to cut costs) and

FDI to acquire resources (including strategic assets).

Based on the methodology of UNCTAD (2006) we can distinguish between driving forces and determinants of FDI. The determinants of FDI are predominantly macroeconomic indicators that are largely static and change significantly only in the medium and long term. The most substantial determinants of FDI are represented by such variables as country's GDP, labor productivity, availability of natural resources and macroeconomic stability. On the other hand, drivers of FDI can relate to both macro- and meso-level matters, such as the scope of regulation and policies and micro-level factors, such as stimulus measures and corporate-level priorities. The article also integrates the paradigm from the fields of international political economics and multinational business, associated with the need for interdisciplinary approaches in this area.

Thus, after presenting the main analytical concept of this article, the next part constitutes a detailed account of the research into the driving forces and determinants for FDI in developing countries.

REVIEW OF RELEVANT SCIENTIFIC LITERATURE

One of the earliest and most important tenets of FDI research is the scholars' contention that market imperfections are one of the main factors driving FDI. In particular, market-oriented FDI aims to penetrate the recipient country's domestic market. The ongoing research estimates the size of the market using GDP (the size of the recipient country), GDP per capita (a measure of the purchasing power of population) and GDP growth (market potential in terms of economic growth). And these figures are expected to be positively correlated with FDI inflows.

An analysis of the empirical data of the postwar years enabled Dunning to single out the income as the main determinant, which gave grounds for further generalization within the Investment Development Path (hereinafter IDP) model. The IDP model demonstrates a non-linear wave-like dependence of net investment flows on GNP/GDP per capita, which goes through five stages in its dynamics. By the end of the second stage the flow of FDI reaches its relative high and the peak of FDI can be seen at the end of the fourth stage. At the same time, developing countries seem to «squeeze» this wave-like curve compared to developed countries, reaching their peak reading at lower income levels. However, developing countries, including those in Central Asia, are very different. As for the driving forces of FDI, since institutionally proximate countries or regions, ceteris paribus, enjoy the greatest investment attractiveness, the leading role in assessing this proximity is played by the so-called «institutional distance». This is an aggregate figure that depends on many other factors of regulatory and fiscal policy, as well as on the level of macroeconomic stability, which in turn depends on the level of political risks and the openness of the recipient economy.

These determinants and driving forces, external objective and subjective factors, significantly affect the motivation of TNCs in relation to the locations of FDI. Another local advantage component deals with internal corporate factors, as well as the standing and preferences of senior management. According to the analysis of Western private companies, the exploration of new markets is the most vivid motivation, followed by efficiency gains and resource development. State-owned companies may show different trends. The specific set of determinants, driving forces and motives shapes a special investment profile of the country, a comparative analysis of which is the main objective of this study.

FDI IN DEVELOPING COUNTRIES

Given the article focus on Central Asia, the authors review studies of FDI inflow in developing countries. Since the early 1980s, scholars have noticed a sharp increase in the number of developing countries and investment in them is considered profitable.

Since FDI inflows contribute to economic growth, including long term horizon, developing countries seek to attract FDI to accelerate the initial development of their capital-intensive industries.

Scholars distinguish between traditional and non-traditional determinants of FDI in developing countries. As for traditional factors for predicting FDI flows to developed countries, such indicators as the size of domestic market, trade balance, as well as GDP, GDP per capita and GDP growth are the most significant determinants for investment flows. In addition, factors, such as restrictions on access to national markets, administrative barriers and risk factors have been proposed as additional traditional factors affecting the attraction or redirection of FDI flows to developed countries.

Globalization process has caused debates over reduced importance of traditional determinants of FDI, such as GDP per capita. Scholars have marked the emergence of non-traditional determinants of FDI: openness to foreign trade, tariff rates and human capital. It is argued that these changes are related to the broader aspect of the transition from FDI focused on the exploration of new markets and resource development to vertical investments or investments aimed at improving efficiency.

CASE STUDY

To investigate the applicability of Dunning's model of drivers and determinants to Russian and Chinese investment in Central Asia this article carries out both qualitative and quantitative analysis of the investments of the two BRICS members in the region. The applicability of the Dunning model is considered for each country, using qualitative and quantitative data and focusing on the FDI development trajectory in the region as a whole and in countries individually. Statistics for both countries is given in the Annex to this article.

EXAMPLE 1: RUSSIA

RUSSIAN FDI IN CENTRAL ASIA

Taking into account both geographical proximity and historical and political heritage, it can be noted that Russia maintains close economic ties with the five Central Asian republics, while the intensity and diversity of these ties vary from country to country. In addition, the economic issues are often inextricably intertwined with security issues.

DETERMINANTS OF FDI

When considering the determinants of Russian FDI in Central Asia, we can identify the following key characteristics.

First, with regard to structural economic indicators, the authors of the article note differences in the correlation between the economic conditions of the five countries in the region and the Russian FDI. While in Kyrgyzstan and Tajikistan, the growth in accumulated Russian FDI shows a moderate positive correlation with the growth in GDP over a given time period, in Kazakhstan and Turkmenistan the trend is reversed with moderately negative correlation coefficients from 2009 to 2020. (Table 1). Uzbekistan doesn't show the same case, with the correlation coefficient being close to 0. As for the correlation between the absolute GDP of Central Asia and the size of the Russian FDI, the authors note that in Kazakhstan there is a moderate positive correlation coefficient, Kyrgyzstan and Tajikistan show high reading and Uzbekistan and Turkmenistan demonstrate moderate and strong negative correlation coefficient respectively. Such results point to the insufficiency of GDP as the only determinant explaining the dynamics of the Russian FDI in the region.

Table 1

Russian FDI: correlation analysis

Correlation (2009-2020)	GDP (USD) and Russian FDI (in absolute terms)	GDP and Russian FDI (annual growth)	GDP and Russian FDI (annual growth)	Labor productivity and Russian FDI (in absolute terms)	Trade openness and Russian FDI (in absolute terms)	Openness and Russian FDI (in absolute terms)
Kazakhstan	0.2875	-0.2626	-0.3681	0.9622	-0.6954	-0.9026
Tajikistan	0.6745	0.2093	0.4288	0.0796	0.0861	-
Kyrgyzstan	0.7125	0.3357	0.2477	0.6484	-0.4994	0.3348
Uzbekistan	-0.8356	0.0052	-0.0070	-0.8275	-0.0702	-
Turkmenistan	-0.7028	-0.2156	-0.2296	-0.7080	0.3415	-

Source: ITC

Second, when approximating a country's economic openness as a share of trade to GDP in %, the correlation with Russian FDI is strongly negative in Kazakhstan and Kyrgyzstan, moderately positive in Turkmenistan and marginally negative and positive in Tajikistan and Uzbekistan respectively. These results imply that a country's openness to foreign trade is not significantly related to Russian FDI in a particular country.

Third, while data on the investment climate, such as the OECD FDI Regulatory Restrictions Index (2021), are available throughout the study period only for Kazakhstan, it can be noted that the gradual increase in Russian FDI in the country is commensurate with the decline in restrictions in the indicated time period, showing a significant negative correlation coefficient. In contrast, in Kyrgyzstan, where these data are available only for 2012, there is a moderately positive correlation between the degree of regulatory restrictions on FDI and the size of Russian FDI, which confirms the assumption that Russian outward investment in the country does not depend on structural and regulatory conditions.

Fourth, with regard to labor productivity, in Kazakhstan and Kyrgyzstan we can observe a high positive correlation with the FDI from Russia, while in Uzbekistan and Turkmenistan the respective correlation coefficients show a significant negative correlation. Finally, in Tajikistan similar figures show a slight positive correlation coefficient equal to 0.08.

Thus, the analyzed macroeconomic indicators show an ambiguous picture in terms of identifying the key factors that determine the size of Russian FDI in Central Asia.

DRIVERS OF FDI

As for the driving forces behind Russian FDI in the CIS, in contrast to Dunning's assertion of firms' effort to reduce costs and gain strategic access to technology through FDI, Russian companies are mainly driven by gaining access to raw materials and local markets for distribution purpose.

Starting to analyze the specific factors affecting flows of Russian FDI in Central Asia, it is worth noting the favorable geographical position of Russia in relation to Central Asia and the high though declining share of Russian speaking population in the region. These factors are «attractive», they reduce the transaction costs of Russian enterprises when investing in the countries of Central Asia. However, the stimulating effect of such "attractive" factors on Russian FDI is offset by administrative barriers, restrictions on foreign investment and high corruption level that potential investors face in the region. As far as market "pushing" factors are concerned, then the relatively large size of the Russian market may offer structural opportunities for Russian investment and joint use of production opportunities in Central Asia. A good example is the recent inflow of FDI in the car making industry in the region.

As for business environment and public policy, the Eurasian Economic Union (hereinafter referred to as the EAEU) has adopted a policy aimed at harmonizing business and investment standards between Russia, Kazakhstan, and Kyrgyzstan in Central Asia, which is an additional driving force for Russian investment in the region. Apart from that, international political conflicts such as the Ukrainian crisis in 2014 have led to a large-scale shift of FDI flows to the CIS region. According to the data released by the Eurasian Development Bank in 2020, Kazakhstan and Uzbekistan ranked first and second among the largest recipients of FDI in the CIS region compared to the second and fifth spots in 2012. The special military operation has also had a serious impact on the dynamics of FDI in the post-Soviet area. Since some of the Central Asian countries are heavily dependent on Russian FDI and have a considerable share of the total FDI of Russia, they face many complications and therefore have significant incentives to reduce their economic dependence on Russia and diversify bilateral economic ties. In particular, according to a recent World Bank report, Russian multinationals, which account for a substantial share of Russian FDI in Central Asia, are expected to face serious challenges in cross-border transactions and logistics due to Western sanctions which will reduce investment opportunities for Russian enterprises in the region. As the problems associated with the economic situation in Russia amid sanctions have caused the depreciation of currencies and rise in inflation in Central Asia, FDI in the region continues to decline which is likely to bring about further investment outflow from these countries.

As for attractive factors related to the business and political environment, developments in Central Asia, such as a change in political leadership, were turning points for Russian FDI. One of the most important examples of political opportunities to attract investment is the transition from rather isolationist foreign policy of Uzbekistan led by Islam Karimov to a multi-vector approach by his successor Shavkat Mirzoev. This political system has led to state support for creating environment for a large-scale partnership and investment between Russia and Uzbekistan. Similar statements on expanding the bilateral investment partnership were made by the presidents of Russia and Kazakhstan after the unrest in Kazakhstan in January 2022.

These political statements on expanding bilateral investment are especially important amid domestic political situation in Kazakhstan since early 2022 and, as a result, the growing caution of foreign investors towards Kazakhstan.

Comparing the relevance of various driving forces behind Russian FDI in Central Asia, it is worth emphasizing the importance of FDI based on access to resources and the lack of substantial FDI focused on efficiency and acquiring strategic assets in the general analysis of investment flows in Central Asia. The priority areas of Russian FDI are closely linked to the energy and hydrocarbon sectors of the region. In particular, Russian investors seek to benefit from acquiring the rights for transit and export of energy from Central Asia and from the exploration and development of hydrocarbon fields. At the same time, it should be noted that three large Russian energy companies rank among top five investors in the post-Soviet area by investment: LUKOIL, Gazprom and Atomenergoprom. In addition, since companies, such as Gazprom and LUKOIL, operate through subsidiaries or joint ventures with local energy companies in Central Asia, they have gained significant leverage on Central Asian energy markets. In addition to the development of hydrocarbon fields in Tajikistan, where Russian direct investment is second only to China, FDI flows can also be seen in the energy sector. At the same time, Sangtudinskaya HPP-1 is Russia's largest investment project in the region.

Moreover, intergovernmental ties between Russia and the countries of Central Asia are a key factor in stimulating bilateral investment cooperation in the region. Meanwhile, political initiatives and regional security issues appear to be important catalysts for Russian FDI and Russian economic activity in Central Asia in general. Russian politicians often emphasize the large scale of Russian investment in the region as well as the economic concessions to the countries of the region to show Moscow's benevolent relations with the five Central Asian republics. These political factors driving Russian FDI in Central Asia stem from the central role that the region plays as an area of special interest. Consequently, some unprofitable Russian FDI projects in the region, such as the modernization of the gas distribution system of Kyrgyzstan by Kyrgyzgas, a subsidiary of Gazprom, were de facto viewed as economic aid to stimulate the country's accession to the EAEU. Given latent domestic political instability in Central Asia and the detrimental impact of political unrest in the region on Russia's status as a guarantor of security, FDI also serves as a tool for strengthening countries' domestic stability in the region.

ANALYSIS OF RUSSIAN FDI TRAJECTORIES TO CENTRAL ASIAN COUNTRIES IN 2009-2020

Having studied the main driving forces and determinants of Russian FDI in Central Asia, it is possible to get down to the analysis of quantitative time trajectories of flows and accumulation of Russian FDI in the region. Figures 1 and 2 show trajectories of Russian FDI in Central Asia from 2009 to 2020.

It can be noted that in the total Russia's FDI flows Central Asia occupies an important spot: this region accounts for 1.93% average annual share of Russian FDI. Between 2009 and 2020, Russian FDI amounted to $7.48 billion. Moreover, the importance of this region as a recipient of Russian foreign investment is somewhat higher than that of France. Compared to total Russian FDI to other sub-regions of the post-Soviet area, investment in Central Asia is more than five times higher compared to the countries of the Caucasus (Armenia, Azerbaijan, Georgia). At the same time, this region accounts for about half of the total Russian investments in the countries of the Baltic and Black Sea regions (Belarus, Ukraine, Moldova).

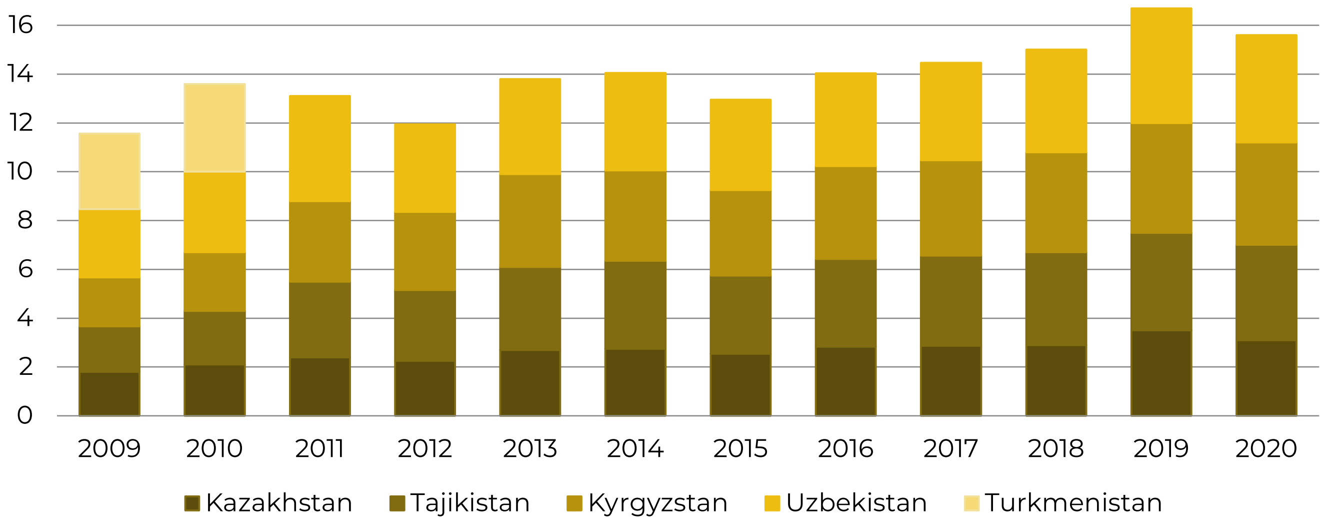

Figure 1. Russian FDI in Central Asia (US$ bn, 2009-2020)
Source: ITC

When examining the differences in Russian FDI flows to individual countries, it becomes clear that there is a serious asymmetry between the five republics. For instance, Kazakhstan, which attracts 509 million dollars of Russian FDI annually, receives on average about 82% of Russian FDI between 2009 and 2020, while the other four Central Asian countries attract far less investment. While Kyrgyzstan and Uzbekistan, with an average annual Russian FDI inflow of 53.4 billion dollars and 13.6 billion dollars, respectively, ranked second and third among the Central Asian recipients of Russian foreign investment, Tajikistan and Turkmenistan accounted for an average of about 2% and 1.5%. Thus, by the amount of Russian FDI in Central Asia in 2020 Kazakhstan accounts for more than 80% of the accumulated investment to Central Asia, the share of Tajikistan is 8%, Uzbekistan and Kyrgyzstan make up about 5.2% and 4.1% respectively.

Apart from that, the study of individual trajectories of recipient countries of Russian FDI in the region allows us to talk about the stimulating role of political initiatives for attracting FDI. After Kyrgyzstan joined the EAEU, between 2014 and 2015, the country experienced a more than threefold rise in Russian FDI. At the same time, this growth remained fairly stable until 2016 and 2017, but after 2018 it has decreased significantly. However, a similar trajectory was not observed in Kazakhstan, where there was an almost linear decline in the annual flows of Russian FDI since 2013, with the exception of 2017, when large-scale government initiatives were taken to increase the attractiveness of the country for foreign citizens.

As for the countries outside the EAEU, after the change of leadership in Uzbekistan, the inflow of Russian FDI surged as the Uzbek-Russian investment agreements were signed. Thus, starting from 2019, Russian investment differed drastically compared to the relatively low figure from 2012 to 2015. Unlike the case with Uzbekistan, the flow of Russian FDI to Tajikistan is more volatile: FDI reached its first peak in 2011 at 47.64 million dollars, then started to decline, and in 2019 there was a sharp rise to 52.34 million dollars, which coincided with the overall increase in foreign investment inflows into the country after a series of investment deals signed in 2018. The annual size of Russian FDI in Turkmenistan is relatively unstable: investment reached its high in 2009 and 2015 (55.08 and 130.34 million dollars), after which it collapsed owing to the decision of Gazprom to completely cease gas imports from the country.

CONCLUSIONS

Summarizing the results of the analysis of Russian FDI in Central Asia, it is worth noting that government initiatives and political goals play an important role in shaping the dynamics of Russia's trade and investment policy in the region. At the same time, it cannot be denied that the analysis of regional integration projects, such as the EAEU, where Kazakhstan and Kyrgyzstan have full-fletched member status (Uzbekistan has had observer status since 2020), shows different results for these three countries. While Kyrgyzstan's accession to the organization led to a short-term increase in Russian FDI, in Kazakhstan and Kyrgyzstan the effect was less pronounced. Such dynamics confirms the assertions of experts that such projects are implemented primarily for domestic political rather than economic reasons. The above findings support the hypothesis given in this article that growth trends in Russian FDI and exports are often associated with announcements of large state trade and investment agreements, mainly in the energy sector.

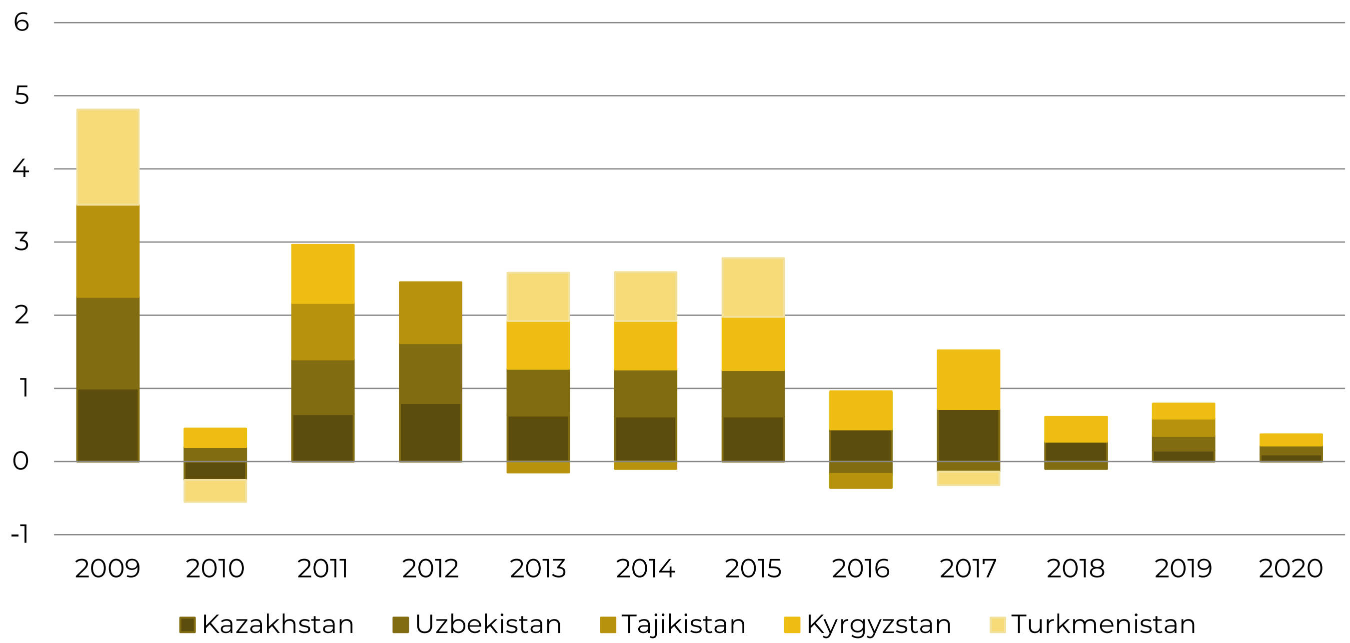

Figure 2. Russian FDI in Central Asia (US$ bn, 2009-2020)
Source: ITC

DRIVERS AND DETERMINANTS OF CHINESE FDI

KEY DRIVERS OF FDI

As for the domestic market situation, the overcapacity faced by China's manufacturing, construction and emerging industries has been an important "pushing" factor for Chinese FDI. Given that Central Asia is undergoing a period of «great transformation», the emerging nature of the region's economies may allow them to absorb China's excess manufacturing capacity, making them attractive to Chinese FDI. GDP growth can be viewed as an indirect indicator of the prospects for FDI and the sustainable dynamics of economic indicators. Thus, this indicator can be very useful in analyzing the ability of countries to absorb excess production capacity. The average GDP growth of the Central Asian states since independence (3.07%) is much higher than those of Japan (0.75%), the US (2.30%) and the EU (1.46%). Moreover, the important role of transport infrastructure for China's Belt and Road Initiative may constitute the country's willingness to expand its access to world markets. Central Asia geographically bridges Western Asia with Europe, attracting Chinese FDI related to transport and logistics.

However, the relatively small size of some markets in Central Asia limits the number of Chinese firms willing to invest in them. The five Central Asian countries have very different GDP figures. For instance, in 2020 the GDP of Kazakhstan was more than 20 times the GDP of Kyrgyzstan. The correlation between Chinese FDI and GDP growth is either weakly positive (Tajikistan and Turkmenistan) or negative (Kazakhstan, Kyrgyzstan, Uzbekistan), suggesting that there are factors other than market size and market entry opportunities that matter to Chinese FDI in the region (Table 2). In addition, China lacks linguistic advantage and common Soviet heritage that the countries of Central Asia share with Russia. In contrast, the Sino-Soviet border conflicts of the 1960s and 1970s additionally contributed to anti-Chinese sentiment in the region. People of China and Central Asia have little knowledge of each other and lack professional ties and relationships. Thus, it is worth considering other factors that facilitate the inflow of Chinese FDI in the region.

Table 2

Chinese FDI: correlation analysis

Correlation (2009-2020)	GDP (USD) and Russian FDI (in absolute terms)	GDP and Russian FDI (annual growth)	GDP and Russian FDI (annual growth)	Labor productivity and Russian FDI (in absolute terms)	Trade openness and Russian FDI (in absolute terms)	Openness and Russian FDI (in absolute terms)
Kazakhstan	0.4202	0.593	-0.096	0.4949	0.8464	-0.5797
Tajikistan	0.0663	0.5195	0.1957	0.4778	0.9699	-

Kyrgyzstan	0.7057	0.8759	-0.242	0.0976	0.9801	0.8198
Uzbekistan	-0.3171	-0.116	-0.729	0.1178	0.7552	-
Turkmenistan	-0.2069	-0.234	0.2448	-0.085	-0.2407	-

Source: ITC

As for production costs, while low labor costs used to give the country a significant competitive edge in attracting FDI, now China itself is looking for low-cost manufacturing abroad. Central Asia may offer China some advantages given relatively low wages. There is a strong positive correlation (not lower than 0.76) between Chinese FDI in Central Asia and labor productivity for all countries of Central Asia except for Turkmenistan. However, Chinese firms engaged in FDI generally do not employ workers from Central Asia, preferring to offer lending facilities subject to use of Chinese technology and employees. At the same time, capital-intensive mining operations do not require a large amount of labor at all. Indeed, more than 60% of projects within the Belt and Road initiative are allocated among Chinese enterprises.

The guidelines for doing business in Kazakhstan released by the Ministry of Commerce of China highlight the low level of skills and productivity of local workers, thereby demonstrating the reluctance of Chinese firms to use labor from Central Asian countries. However, the Chinese insurance company Sinosure made a similar comment regarding the labor force in Tajikistan. Thus, cheap labor in the countries of Central Asia is not always an «attractive» factor for Chinese FDI, so its use to justify Chinese FDI in the region is limited. The favorable tax regime and the openness of the Central Asian economies represent a factor attracting FDI to the region. China has signed double tax treaties and agreements to prevent tax evasion with five countries in the region.

The Tajik government often provides tax incentives or free land for Chinese investment. For instance, in 2019 the Chinese company Kashgar Xinyu Dadi Mining Investment signed a contract with the Committee on Investments and State Property of Tajikistan to develop the Yakjilva silver deposit and gained tax exemption on any income and equipment imported into the country to service mines for seven years. Two Chinese companies investing in Kyrgyz refineries noted that support from the recipient government (through subsidies) was a critical factor in deciding on investment. At the same time, the challenging business environment and pervasive corruption in Central Asia reduce the effectiveness of the region's business environment as an «attractive» factor for FDI.

MAIN DETERMINANTS OF FDI

There is an assumption that Chinese firms (as well as successive governments) adopted a strategy of seeking new markets to carry out FDI in Central Asia. For instance, a number of scholars indicate a statistically significant correlation (at 1% level) between the size of the recipient economy and Chinese FDI. There is a significant positive correlation between FDI and GDP for Kazakhstan (0.59), Kyrgyzstan (0.88), Tajikistan (0.52) and the region as a whole (0.82), although Turkmenistan and Uzbekistan show a weak negative correlation, which perhaps indicates the heterogeneity of the economic situation in the five countries of the region.

To solve the problem of overcapacity in 1999 the Chinese government started to implement a policy «Exit», and in 2013 – the Belt and Road initiative. These programs are aimed at stimulating domestic demand by using China's capital reserves to invest abroad and expand foreign demand for Chinese goods and services. Chinese companies tend to implement infrastructure projects under the auspices of the Belt and Road initiative, which allows them to gain external benefits through investment. For instance, the main partner in the project for the construction of an alternative north-south road in Kyrgyzstan (financed by $850 million loan from Chinese Eximbank) is China Road and Bridge Corporation (CRBC). The US State Department notes that Chinese Eximbank loans for infrastructure projects in Kyrgyzstan made it easier for Chinese enterprises to enter the market. This trend demonstrates the progress made by China in achieving its goal of entering new markets.

Given the limited market size of many Central Asian countries, the governmental nature of market expansion measures (particularly through Exit policy and the Belt and Road initiative), the importance of state-owned enterprises in China's FDI and the implementation of the Chinese state capitalism model should be considered as part of the government's priorities in the region. The activity of Chinese companies abroad is primarily aimed at making profit, but the above companies should also be in line with the broad political goals of the Chinese government and promote these goals (or be seen advancing them). Since at least 2015 reduction in overcapacity has been one of the top five objectives of China's economic reform. Thus, the Chinese government's FDI policy can be seen as part of a broader government effort to reduce excess production capacity.

FDI aimed at discovering and exploring resources, such as hydrocarbons, are especially important for China due to the lack of natural resources in the country. For instance, 72% of oil and 43% of gas are imported. There is a strong positive correlation between Chinese FDI and natural resources at 1% level, demonstrating the predominance of the factor related to the search for resources for Chinese FDI. The fact that the entire production chain (from mining to processing and supply) is controlled by China demonstrates that China's interest in the region is one of the main goals of the government to ensure energy security.

The geographical proximity of Central Asia to China and abundant natural resources and minerals in the region (especially oil in Kazakhstan and gas in Turkmenistan) make Central Asia an attractive destination for Chinese FDI aimed at ensuring the country's resource and energy security. In 2017 two of the largest Chinese investment projects in the energy sector were in Central Asia: an oil pipeline from Kazakhstan and Central Asia-China gas pipeline (with participation of all five countries of Central Asia, currently three lines are in use and the fourth is planned), which clearly shows the investment attractiveness of the region.

Looking at the countries of the region individually, about half of the 55 Chinese FDI projects announced in 2017 as part of the Kazakh-Chinese industrial cooperation initiative account for the oil and gas sector and 22% account for the mining and metallurgical industries. While the data for Turkmenistan is very limited, the available figures suggest that the country is important to China's resource development and energy security goals. For instance, in 2002 CNPC signed a contract with the state concern Turkmenneft to develop the Gumdak oil field and received a 100% stake in the project for five years. In 2021 Turkmenistan was the second largest exporter of natural gas to China (after Australia) and the largest exporter of pipeline gas to China. In the same year, the China Petroleum Engineering and Construction Corporation (CPEEC) and its subsidiary CNPC signed a contract to develop onshore gas facilities in Bagtyyarlyk, demonstrating China's ongoing FDI partnership with Turkmenistan. In 2014 Tajikistan and the Chinese company Heli signed an agreement for the construction of an oil refinery in the Dangara Special Economic Zone which was completed in 2020. In addition to the oil and gas sector a significant amount of Chinese FDI was also directed to the production of metal ores in Tajikistan.

And although a number of experts argue that China is currently diversifying its FDI models in Central Asia, the country's investments remain concentrated in infrastructure, in energy sector particularly. For instance, during the visit of Prime Minister T.A. Sariev to Beijing in 2015.

General Secretary of the State Council of the People's Republic of China Li Keqiang stressed China's readiness to discuss production capacity and investment cooperation with Kyrgyzstan. At the same time T. A. Sariev welcomed China's investments in energy, transport and social infrastructure.

In addition to ensuring the security of energy supplies the Chinese government has other priority political interests in investing in Central Asia. Policymakers hope that the Belt and Road initiative and other investment projects will help create new markets to stimulate trade and catalyze the development of the country's western regions, in particular the Xinjiang Uygur Autonomous Region, which borders three Central Asian countries and has oil and gas pipelines from Central Asia in its territory.

And economic development is seen as a way to resolve the problem of economic development and political discontent in Xinjiang. For instance, in 2010 China ratified a document on creating a new free economic zone (FEZ) in Xinjiang to turn the nearest frontier port of Khorgos into a center of trade relations with Kazakhstan.

The issue of prestige may also be important for Chinese FDI in the region. Indeed, the Belt and Road initiative is largely based on the historical legacy of the Great Silk Road, when China represented the civilizational and economic center of the world. At present, China intends to once again take on leading global political and economic role. By fighting poverty and supporting education and science the country is able to «gain diplomatic points» and «strengthen its political influence». The role of Beijing as an indispensable player in the region is growing thanks to a wide network of trade and transport links, as well as the development of multilateral institutions for cooperation with China at the center of these initiatives. On the other hand, given that a positive correlation between Chinese FDI and trade openness is observed only in Uzbekistan and Turkmenistan, it can be noted that China does not consider openness of the Central Asian economies as a factor that determines investment in these economies. This trend supports the hypothesis that political rather than economic motivation drives Chinese FDI.

ANALYSIS OF CHINESE FDI TO CENTRAL ASIA IN 2009-2020

There was a significant positive trend between 2009 and 2020 with the accumulation of Chinese FDI in Central Asia, with investment more than quintupling from $2.26 billion to $12 billion in 2020. Since the launch of the Belt and Road Initiative in 2013 Chinese FDI in the region has almost doubled. However, the average annual FDI growth was higher before (43.8%) than after its launch (10.11%). It can be probably explained by the fact that China's political goals and the «Belt and Road» concept precede the implementation of this initiative. Comparing Chinese FDI in Central Asia with other regions of the world we can see that Central Asia (79.4 billion dollars) ranks between Russia, which is a neighboring country of China (85 billion dollars), and Canada, which has a high income level (71.7 billion dollars). The share of Central Asian FDI in China's investment portfolio may seem insignificant (0.89% on average). However, among the 146 countries participating in the Belt and Road Initiative Central Asia ranks third (following Singapore, a tax haven, Luxembourg, a high-income country, and Russia, whose official participation in the initiative is still being discussed). These figures reflect the important role of Central Asia in the Belt and Road Initiative given the region's strategic position and abundance of natural resources.

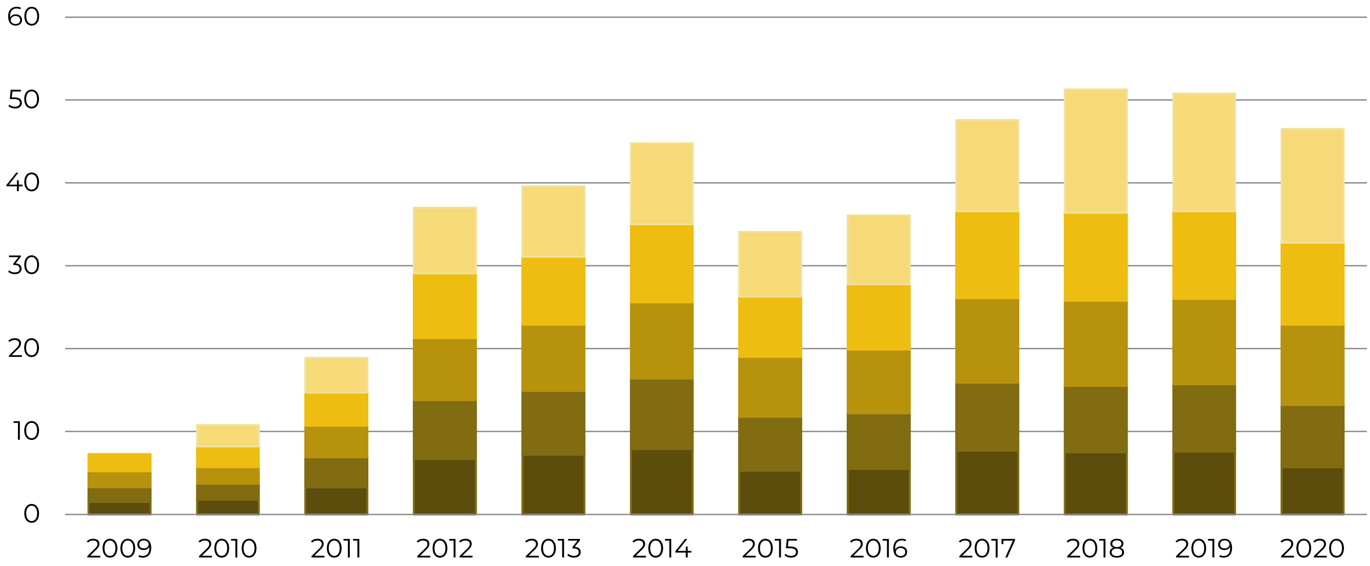

Figure 3: Chinese FDI in Central Asia (US$ bn, 2009–2020)
Source: ITC and China Statistical Yearbook

Chinese FDI flows to Central Asia are much more volatile than outward investment. Although in annual terms FDI in the region accounts for a similar share of China's total FDI relative to outward FDI, it does not show an overall positive trend. FDI flows to Central Asia peaked in 2012 (the year before the launch of the Belt and Road initiative) and reached its low in 2015 (amid an outflow of investment, coinciding with the fall in oil prices). Like Russian investment in Central Asia, a significant share of accumulated Chinese FDI (at least 50%) and FDI flow over the period was in Kazakhstan. Indeed, in 2009-2018 Kazakhstan was the fifth largest recipient of Chinese FDI within the Belt and Road initiative (following Indonesia, Singapore, Luxembourg, and Russia). These figures reflect China's goals of exploring new markets and developing resources, given that Kazakhstan has the largest GDP in the region, ranks first in the Human Development Index (HDI) and possesses substantial natural resources. However, immediately after the financial crisis Turkmenistan received more FDI from China possibly due to its participation in the development of the Galkynysh oil field. Moreover, since 2012 there has been a marked decline in the amount of Chinese investment in Kazakhstan possibly reflecting risk diversification by Chinese banks, a desire to move beyond simply finding and exploring resources in the region and the impact of anti-Chinese protests in the country caused by Chinese FDI and land reforms. This decline occurred regardless of a joint declaration by China and Kazakhstan on a new stage of comprehensive strategic partnership in August 2015, a joint plan to ensure synergy in the development strategies of two countries (the Belt and Road initiative and Nurly Zhol) in September 2016 and a new Kazakhstan status of «permanent comprehensive strategic partner» of China in 2019.

Over the specified period Chinese FDI in Uzbekistan surged compared to total Chinese investment in the region, rising from less than 4% in 2009 (when the country received the least amount of Chinese FDI in the region) to more than 25% in 2020 (the country ranked second in FDI in the region). A noticeable rise occurred in 2018 which coincided with the beginning of the presidential term of S.M. Mirziyoyev (in 2016) and indicates the importance of political factors for FDI.

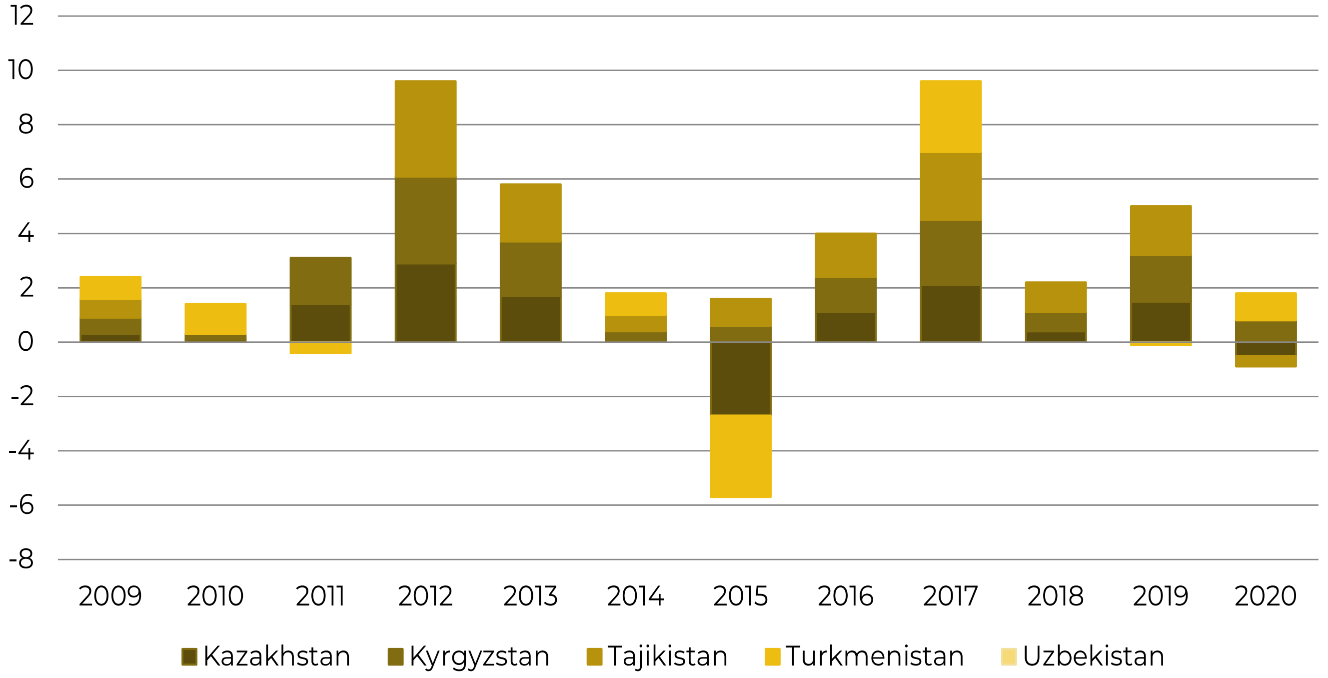

Figure 4. Russian FDI flow to Central Asian countries (US$ bn, 2009-2020)
Source: ITC and China Statistical Yearbook

FINDINGS

An analysis of the drivers and determinants of Chinese FDI in Central Asia shows the importance of search for new markets and development of resources for FDI. These factors are largely related to general geo-economic and political priorities. Although there is a positive trend in the accumulation of Chinese FDI in Central Asia, there are significant fluctuations and discrepancies in the breakdown of data by country in this region. Kazakhstan is important for Chinese FDI in the region, which is consistent with the hypothesis of the impact of such factors as the exploration of new markets and the development of resources. At the same time, the importance of this country is waning, while other countries of Central Asia, especially Uzbekistan, are becoming more important for Chinese FDI.

COMPARISON OF RUSSIAN AND CHINESE FDI AND EXPORTS TO CENTRAL ASIA IN 2009-2020

Analyzing the absolute value of FDI from Russia and China to Central Asia there is no clear pattern as to which country invests more in the region: both countries generate approximately the same average FDI flow of 623.6 million dollars (Russia) and 721.8 million dollars (China).

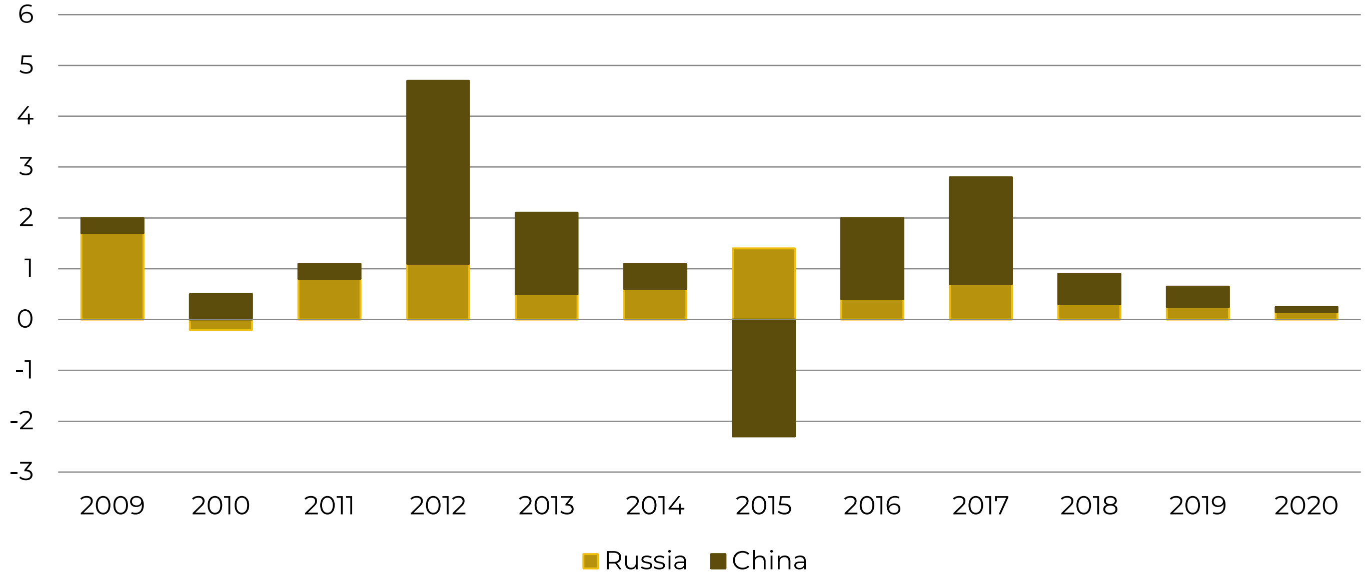

Figure 5. Russian and Chinese FDI in Central Asia (US$ bn, 2009-2020)
Source: ITC and China Statistical Yearbook

Less volatile FDI statistics shows a clearer picture of the differences between Russian and Chinese FDI. Thus, over the period accumulated Chinese FDI in the region considerably exceeded that of Russia. It should be noted that before 2011 Russian FDI in the region was higher than FDI of China. The shift from Russian FDI to Chinese FDI is observed in the gas industry of Turkmenistan, where the China-Central Asia gas pipeline construction at the end of 2009 led China to increase gas purchase from 5 billion cubic meters in 2010 to more than 33 billion cubic meters surpassing Russia, which until 2020 was the largest buyer of gas in Turkmenistan.

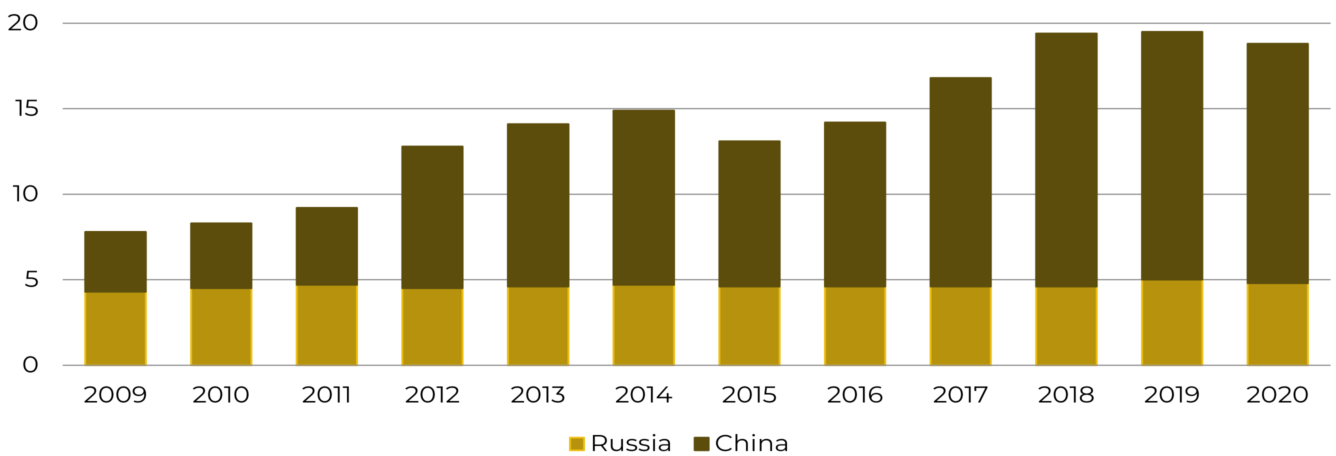

Figure 6. Russian and Chinese FDI in Central Asia (US$ bn, 2009-2020)
Source: ITC and China Statistical Yearbook

Although in absolute terms China has invested in Central Asia more than Russia, for Russia, in some respects, this region is more important than any other country, perhaps due to mutual historical and cultural ties. In particular, over this period Central Asia received 0.89% of China's total FDI compared to 0.94% of Russia's total FDI, while 1.84% of Russian FDI was allocated in Central Asia against 0.72% of China's FDI. China's higher economic growth and larger economy is the reason why China is economically active in Central Asia notwithstanding the fact that the region accounts for a small share of the country's total FDI.

CONCLUSION

The analysis shows that Central Asia as a destination for FDI is slightly more important for Russia than for China, while the regional projects of two BRICS countries, the EAEU and the Belt and Road initiative, seem to have had a mixed impact on FDI and exports in the region. The determinant for Russian and Chinese FDI in Central Asia is access to natural resources and their transportation. Kazakhstan's large oil resources represent an FDI «attractive» factor for both Russia and China, therefore Kazakhstan receives the largest FDI (and the largest exports) from two BRICS countries among all Central Asian states. The countries of Central Asia, which are not rich in hydrocarbons, receive a significant amount of investment in the development of energy transportation routes.

Analyzing the respective FDI patterns of two countries, it is clear that political and security considerations often outweigh the economic risks. Russia does not want to give up control over its former «sphere of influence» to ensure stability in neighboring countries. As for natural resources, the country seeks to obtain the rights to transit and explore hydrocarbon fields outside its territory. The huge size of China's economy requires significant investment in energy, while FDI in the region is seen as a way to combat problems in Xinjiang and revive the Silk Road era. Moreover, such political factors as the presidency of S.M. Mirziyoyev in Uzbekistan influenced FDI and the structure of exports in the region.

By contrast, Russian and Chinese FDI is not driven by factors such as efficiency gains and the acquisition of strategic assets. Although some Chinese and Russian FDI may be aimed at exploring markets (China additionally uses the region to access the markets of other Western countries), difficult business environment, corruption and the limited size of some countries' economies put a strain on FDI flow to the region. At the same time there is a significant positive correlation in Kazakhstan between the investment climate and Chinese FDI for the specified period (0.82), for Kyrgyzstan this correlation is inverse (-0.57).

It is also worth noting that wider macro-regional and multilateral cooperation in Central Asia, for instance, through the BRICS platform, could be a significant benefit for China and Russia. It can help China overcome the backlash that the country faces in response to investments in the region and address the problem of energy security, while helping to maintain Russia's influence in the region, as well as strengthening the institutionalization of the two countries' corresponding regional projects.

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