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“China’s Energy Engagement with Central Asia and Implications for the United States”

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Chairman Rohrabacher, Ranking Member Keating, Members of the Subcommittee, thank you for the opportunity to testify today. Before I begin, I would like to note that this testimony reflects my personal views and not necessarily the judgments of the U.S.-China Economic and Security Review Commission.

Over the last decade, China’s engagement with its Central Asian neighbors has grown significantly, largely due to Beijing’s efforts to boost energy security and enhance stability in China’s western provinces. In a region with a long history of Russian control and influence, China now is the most influential and powerful economic actor and is poised to eventually surpass the United States and Russia as Central Asia’s preeminent foreign power.

Drivers of China’s Increasing Energy Engagement with Central Asia

The Chinese government is increasing its economic ties with Central Asia, particularly in the energy sector, for two main strategic reasons.

First, Beijing is expanding its energy relationship with Central Asian states as part of a multifaceted, long-term energy security strategy. By doing so, China can diversify the types and sources of energy to reduce the risk of disruption from any one supplier. For years, Chinese leaders have viewed the growing reliance on foreign supplies of energy as a vulnerability to the country’s economic growth, the cornerstone of the Chinese Communist Party’s legitimacy. Underpinning this concern is Beijing’s fear that an economic slowdown could destabilize the regime.

In the long term, Central Asian oil and natural gas will fulfill some of China’s energy needs, but it will by no means be a game changer for Chinese energy security. Some Chinese policymakers and strategists argue that Central Asian energy imports will lessen China’s reliance on seaborne energy, thereby mitigating China’s “Malacca dilemma,” or vulnerability to potential future efforts by other countries (such as the United States) to blockade Chinese trade at critical maritime chokepoints. This assumption is misguided, however. China’s oil demand growth is such that the share of seaborne imports (primarily from Saudi Arabia) will increase even if all China’s planned overland energy routes are realized. Moreover, energy supplies transported via Central Asian pipelines are likely to be more expensive and more vulnerable than seaborne supplies to both physical attack by terrorists or other parties and unintentional disruption.¹

*Second, Beijing seeks to promote the security and development of its Xinjiang Autonomous Region.*² Poverty, ethnic tensions, and repressive government policies have led to episodic unrest, engendered political movements for Xinjiang’s independence or autonomy from Chinese rule, and sometimes resulted in violence and terrorism. Beijing judges increased economic ties between China’s westernmost region and Central Asia will raise the welfare of its Uyghur population, the largest ethnic minority in Xinjiang, thereby helping to rein in ethnic unrest and further assimilate minorities into China’s majority ethnic Han society. In 2010, then-President Hu Jintao announced that China would bring Xinjiang residents’ per capita GDP up to the national average by 2015.³ Furthermore, China’s foreign policy community is publicly debating a grand strategy, known as “Marching Westward,” that calls for China to shift its attention from East Asia and “rebalance” its strategic focus to the vast area from Central Asia to the Middle East.⁴

Additionally, Beijing is pursuing broader security interests in Central Asia. China uses its limited, but growing, defense ties in the region⁵ to increase China's influence, decrease regional reliance on the United States for security, counter perceived U.S. efforts to encircle China, and reduce suspected support by Central Asian entities to violent separatists groups in western China.⁶ Nevertheless, China's defense engagement in Central Asia remains secondary to economic engagement as Beijing continues to primarily address its regional security concerns through economic means.

Manifestations of China-Central Asia Energy Ties

China's energy inroads into Central Asia are manifest in oil and natural gas imports transported via pipeline, investment in Central Asian energy companies and projects, and loans to Central Asian countries for energy projects and production.

Trade

China sources most of its oil from the Middle East and Africa. Only about 4 percent of its imported crude comes from Kazakhstan.⁷ Nevertheless, imports from Kazakhstan have doubled from about 5 million tons in 2008 to 12 million tons in 2013⁸ and are growing at a faster rate than China's overall oil imports. China's reliance on Kazakh oil is likely to grow in the future.

Turkmenistan accounts for more than half of China's total natural gas imports,⁹ and its future share of imports will likely increase as well. China and Turkmenistan plan to elevate imports from 20 billion cubic meters per year in 2013 to 65 billion cubic meters by 2016.¹⁰ Uzbekistan, a country rich in natural gas but with little capacity for export, began exporting natural gas to China in 2012.¹¹ In 2013, Uzbekistan supplied 2.1 million metric tons of natural gas to China, a substantial increase over 2012 levels.¹²

All of China's Central Asian hydrocarbon imports are transported via two pipeline networks: the Kazakhstan-China oil pipeline and the Central Asia-China Gas Pipeline, which traverses Turkmenistan, Uzbekistan, Kazakhstan, and China. Kazakhstan delivers oil to China's Xinjiang Autonomous Region via the Kazakhstan-China pipeline, and Turkmenistan and Uzbekistan deliver natural gas to Xinjiang via the Central Asia-China Gas Pipeline. Constructed in only 18 months, the Central Asia-China Gas Pipeline was the fastest built pipeline of its size in history.¹³ Chinese state-owned banks and national oil companies have been heavily involved in the financing, ownership, and operation of these pipelines.

As a trade partner, China is now rivaling Russia in the region. China's trade with Kazakhstan, the region's largest economy, amounted to \$23 billion in 2012, neck-in-neck with Russia's \$24 billion. In 2003, China-Kazakh trade totaled just \$3 billion. Kazakhstan in 2012 sent 18 percent of its total exports to China, almost three times the share it sent to Russia.¹⁴ China has thus become an expedient means for Kazakhstan to earn foreign currency. In the case of Turkmenistan, the region's second-largest economy, the pattern is even starker: the gas producer sent 70 percent of its exports to China in 2012, versus just 2 percent to Russia.¹⁵

Investment

Kazakhstan is Central Asia's dominant oil producer, and in 2012 received two-thirds of all foreign direct investment in the region.¹⁶ Not surprisingly, it has been the primary recipient of Chinese investment in Central Asian oil over the past two decades.¹⁷ China's largest national oil company, China National Petroleum Corporation (CNPC), is the majority owner of two of Kazakhstan's major oil companies (it owns 85.42 percent of AktobeMunaiGas and 67 percent of PetroKazakhstan) and is involved in several oil exploration and production projects throughout the country.¹⁸ The company also provides oilfield services in Kazakhstan¹⁹ and plans to build a refinery there.²⁰ China's sovereign wealth fund, China Investment Corporation, also invested almost \$1 billion in Kazakh energy in 2009.²¹ Chinese companies own so many projects (or stakes in projects) in Kazakhstan that experts estimate China controls between 25 and 50 percent of the country's oil production.²²

Chinese investment in Central Asian natural gas is focused on Turkmenistan. Although Turkmenistan has the sixth-largest natural gas reserves in the world, the government's aversion to foreign investment has made it difficult for the country to take full advantage of its energy wealth.²³ China is the only country that has been able to significantly penetrate Turkmenistan's opaque energy sector, and CNPC is the dominant foreign player in its onshore production.²⁴ The Chinese company reportedly has invested \$4 billion in Turkmenistan's Bagtyiarlyk project through a 35-year production-sharing agreement. Natural gas from this project supplies the Central Asia-China Gas Pipeline.²⁵ According to the late Alexandros Petersen, former advisor to the European Energy Security Initiative at the Wilson Center, CNPC plans to distribute Turkmen gas from the pipeline to other countries in the region in addition to importing into Xinjiang.²⁶ CNPC is also jointly developing South Yolotan, the second-largest gas field in the world, which eventually will feed into the pipeline as well. This project includes gas processing facilities operated by CNPC.²⁷

Other Central Asian countries hold potential for increased Chinese investments. Tajikistan has not experienced the level of investment of its energy-rich neighbors but may have significant gas resources. By one estimate Tajikistan could possess 114 trillion cubic feet of gas, making it the second-largest reserve of natural gas in Central Asia.²⁸ In 2012, CNPC began exploring Tajik oil and gas potential.²⁹ Another recent development is Chinese investment in Kyrgyzstan. In late 2013, China financed the construction of Kyrgyzstan's first oil refinery, ending that country's complete dependence on Russian oil.³⁰ However, as of February 2014, Kyrgyzstan's prime minister suspended work at the refinery after local residents protested conditions there.³¹

As in the case of trade, China is becoming a more prominent player than Russia on the investment front. According to the Kazakhstan Chamber of Commerce in the United States, Russian investments in Kazakhstan's oil and gas sector are estimated at \$4.5 billion, including some \$1.4 billion in direct investment. Nonetheless, "Russian activities have so far been relatively limited, especially compared to Chinese companies which had consistently increased their share in Kazakhstan's oil and gas sector."³²

Loans

Since 2009, Chinese state-owned entities have extended at least \$32.3 billion in loans to finance oil and gas development, production, and exports in Central Asia. During a high-profile tour of the region late last year, Chinese President Xi Jinping reportedly signed agreements for \$8 billion in additional loans to Kazakhstan.³³ These disbursements are part of China's global "oil-for-loans" strategy: China's two state-run policy banks, China Development Bank and China Export-Import Bank, issue subsidized loans to developing countries in need of cash, and in return, China secures long-term supplies of oil and gas at stable prices. Outside Central Asia, prominent recipients of such loans are Venezuela and Angola – not to mention Russia. For China, "oil-for-loans" deals have several benefits: China builds up a buffer of supplies against the volatile energy market; puts its huge surplus of dollar reserves to effective use; and sells other Chinese goods and services, such as civil engineering work and construction machinery, to the borrowing country as part of the loan.

Oil-for-loans are usually brokered directly with a national government or a state-owned energy company. In Turkmenistan, China Development Bank has loaned \$8.1 billion to Turkmenengaz, the country's national natural gas company, for the development of the South Yolotan gas field. Turkmenengaz is repaying these loans with natural gas exports to China.³⁴ Similarly, China Export-Import Bank has extended \$5 billion to the Kazakh government and CNPC issued \$5 billion to Kazakh national oil company KazakhMunaiGas.³⁵

Concurrently, China's policy banks lend to Chinese companies that do business in the region. China Development Bank, for instance, has financed CNPC's \$4.2 billion purchase of a 20 percent stake in Kazakhstan's PetroKazakhstan; CITIC Group's \$1.9 billion purchase of a Kazakh oilfield; and the \$8.1 billion construction of the Central Asia-China Gas Pipeline.³⁶

Geopolitics can also factor into these loans. The South Yolotan project in Turkmenistan is one example. Turkmen officials sought the loan from China almost immediately after a costly explosion of a pipeline that sends natural gas to Russia. Turkmenistan blamed the explosion on Gazprom, Russia's largest natural gas company. The incident stoked tensions, and Gazprom cut off the flow of Turkmen gas to Russia for

months. That led Turkmenistan to seek ways to diversify its natural gas exports away from Russia and toward China.³⁷

Implications of China's Growing Engagement with Central Asia

Social and Economic Implications

Many Central Asian governments welcome China's increasing economic engagement. Chinese investment, trade deals, and loans have enabled economic growth and development in a low-income area of the world with poor infrastructure and a lack of competitive industries. In Turkmenistan, for example, Chinese engagement has given the country's energy sector a much-needed boost, not just by investing in production but also by bringing Turkmenistan's vast natural resources to market via the Central Asia-China Gas Pipeline.

Chinese economic engagement in Central Asia can be a double-edged sword, however. Some civil society groups and other segments of Central Asian society have charged that Chinese investment and loans primarily serve Beijing's economic interests at the expense of local populations. They have also criticized Chinese enterprises for their poor labor conditions, unfair pay, abuse of local workers, and unsustainable environmental practices. In some countries in Central Asia, resentment of Chinese business practices has led to protests, violence against Chinese workers and businesses,³⁸ and government fines of Chinese organizations.³⁹

Central Asian economies are also growing too dependent on energy exports to sustain growth. The dangers of this one-sided approach are well documented. Changes in global commodity prices can destabilize the domestic economy. Resource windfalls can push up the value of the national currency, driving manufacturers out of business and concentrating the workforce in extractive industries. Most important, wealth and power can become concentrated among a small group of rent-seeking elites.

Geopolitical Implications

The rise of Chinese influence in Central Asia at the expense of Russia, coupled with a probable decline in overall U.S. interest in the region after the planned withdrawal of troops from Afghanistan, is likely to shift the balance of power between the major external actors in China's favor. This shift presents both challenges and opportunities for the United States. China's energy ties with Central Asia support U.S. policy efforts to spur economic activity in the region, encourage regional oil and natural gas production, and promote European energy security by weakening Russia's near-total control of regional gas supplies.⁴⁰

However, China's "no strings attached" approach to investment fosters official corruption and waste, which is already rampant in Central Asian government and commercial sectors. This approach also provides Chinese state-owned and state-sponsored enterprises with an unfair advantage over Western investors; many Central Asian governments and leaders take umbrage when Western investment is conditioned on a country's advancement of democratic reform and human rights.⁴¹

Furthermore, Beijing could seek to leverage its position as the region's most influential and powerful economic actor to reap political benefits internationally. According to the International Crisis Group, for example, Kazakh analysts "allege that Chinese officials forge links with the top of the [Kazakh] political elite, so they can influence decisions at the highest levels."⁴² Beijing could use this influence to water down or derail U.S.-backed policy initiatives at the United Nations and other international arenas; undermine U.S. efforts to promote good governance, democracy, and human rights in Central Asia; and weaken U.S. efforts to combat terrorism, piracy, and other transnational threats in the region and around the world.

Moscow has publicly embraced China's emergence as a major player in Central Asia. Some argue that the two countries are keen to cooperate more closely in the wake of the Ukraine crisis. Economically, Russia is also benefiting from China's increasing oil and gas demand; during a visit by President Vladimir

Putin to Beijing this week, China may sign a multibillion-dollar deal to buy Russian gas, a further step in bilateral energy cooperation.⁴³

However, for the time being, China's growing presence in Central Asia appears to be a greater geopolitical concern for Russia than for the United States. China's entry into the Central Asian energy network has significantly weakened Russia's energy dominance – and political influence – in the region. The Chinese market provides Central Asian energy exporters with an alternative to Russia, and this is reinforced by China's investment in pipelines. For example, when the Central Asia-China Gas Pipeline came online, it broke Russia's stranglehold on Central Asian natural gas transit, empowering Turkmenistan to negotiate more favorable terms for the cost and volume of its exports to Russia.⁴⁴ Furthermore, China's energy engagement reduces Russia's access to cheap natural gas from Central Asia, which it has sold at a significant profit to Europe.⁴⁵

With the planned U.S. withdrawal of troops from Afghanistan later this year, Central Asia will no longer be at the center of U.S. global strategy, especially as Washington shifts its focus to the Asia Pacific and reduces its defense budget after more than 10 years at war. In the short term, these changes could exacerbate Central Asia's instability, leading to increased refugee flows, crime, and terrorism. In the long term, decreasing U.S. attention to Central Asia could cause the region to become the focus for great power rivalries. Therefore, as the United States transitions away from its decade-plus focus on Afghanistan, the Obama Administration should review and recast its policy toward Central Asia to ensure the United States remains fully engaged in the region.

Thank you for the opportunity to testify. I look forward to your questions.

Appendix 1: Select Major Chinese Energy Investments in Central Asia

Kazakhstan	<i>Kazakhstan-China Oil Pipeline:</i> CNPC and Kazakhstan's largest state-owned oil company, KazMunaiGaz, built a \$3 billion, 3,000 kilometer (km) pipeline from the Caspian Sea to Xinjiang in 2006. It has a capacity of 400,000 bpd.
Turkmenistan	<i>Central Asia-China Gas Pipeline:</i> CNPC built a \$7.3 billion, 7,000 km natural gas pipeline beginning in Turkmenistan and passing through Uzbekistan and Kazakhstan en route to China. The first part of the pipeline was completed in 2009 and currently has a capacity of 30 bcu per year, with a projection for 80 bcu per year by 2020.
Uzbekistan	<i>Central Asia-China Gas Pipeline:</i> China first imported Uzbek natural gas in 2012.
Kyrgyzstan	<i>Junda Oil Refinery:</i> Zhongda China Petrol Company opened Kyrgyzstan's first oil refinery in 2013, drawing on oil imported from Chinese fields in Kazakhstan. It has a capacity of 12,000 bpd.
Tajikistan	<i>Danghara Oil Refinery:</i> In April 2014, a Chinese company agreed to invest upwards of \$500 million in an oil refinery with a total expected capacity of 24,000 bpd.

Source: Compiled by Commission staff. Information is based on multiple sources.

Appendix 2: Central Asia Proved Oil and Natural Gas Reserves (2014 Estimates)

Country	Oil (billion barrels)	Gas (trillion cubic feet)	Oil Global Rank	Gas Global Rank
Kazakhstan	30	85	13	14
Turkmenistan	0.6	265	42	6
Uzbekistan	0.59	65	43	19
Kyrgyzstan	0.04	0.2	74	82
Tajikistan	0.01	0.2	80	82

Source: U.S. Energy Information Administration.

Appendix 3: China versus Russia Trade in Central Asia: Kazakhstan and Turkmenistan, 2012

	Total merchandise trade (US\$bn)			China share (%)		Russia share (%)	
	Exports	Imports	Balance	Exports	Imports	Exports	Imports
Kazakhstan	\$ 86.4	\$ 46.4	\$ 40.0	17.9%	16.8%	7.3%	38.4%
Turkmenistan	\$ 11.2	\$ 10.4	\$ 0.8	69.5%	19.2%	1.6%	13.7%

Source: World Trade Organization, Eurostat

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- ¹ Andrew Erickson and Gabriel B. Collins, "China's Oil Security Pipe Dream: The Reality, and Strategic Consequences, of Seaborne Imports," *Naval War College Review* 63:2 (Spring 2010): 90.
- ² Xinjiang shares 1,750 miles of borders with the Central Asian nations of Kazakhstan, Kyrgyzstan, and Tajikistan, among other countries. For the purposes of this testimony, Central Asia is defined as Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.
- ³ CCTV.com (English version), "Keynote Conference on Xinjiang Development Held," May 20, 2010. <http://english.cntv.cn/program/newsupdate/20100520/103909.shtml>.
- ⁴ This strategy, known as "March West," was put forward by Wang Jisi, a prominent Chinese scholar, in 2012. Wang Jisi, " 'Marching Westwards': The Rebalancing of China's Geostrategy," *International and Strategic Studies* 73 (October 2012). For analysis, see Yun Sun, *March West: China's Response to the U.S. Rebalancing* (The Brookings Institution), January 31, 2013. <http://www.brookings.edu/blogs/up-front/posts/2013/01/31-china-us-sun>.
- ⁵ Regional military engagement consists of delegation visits typically held alongside Shanghai Cooperation Organization meetings, occasional combined exercises focused on border security and counterterrorism concerns, security assistance, and professional military education.
- ⁶ Political movements for Xinjiang's independence or autonomy from Chinese rule have in the past attracted support from overseas Muslim groups, particularly in the Middle East and Central Asia. Beijing fears these groups could encourage or exacerbate what it refers to "separatist insurgencies" in Xinjiang. U.S.-China Economic and Security Review Commission, *Hearing on China and the Middle East*, testimony of Dawn Murphy, June 6, 2013.
- ⁷ U.S. Energy Information Administration, "China." <http://www.eia.gov/countries/cab.cfm?fips=ch>.
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- ⁹ Murat Sadykov, "Turkmenistan Supplying Over Half of Chinese Gas Imports," *Eurasia Net*, August 6, 2013. <http://www.eurasianet.org/node/67356>.
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- ¹² "China's Dec pipeline gas imports rise 20% on year to 2.56 Bcm," *Platts*, January 22, 2014. <http://www.platts.com/latest-news/natural-gas/singapore/chinas-dec-pipeline-gas-imports-rise-20-on-year-27855257>.
- ¹³ Alexandros Petersen, "Central Asia's New Energy Giant: China," *The Atlantic*, June 28, 2013. <http://www.theatlantic.com/china/archive/2013/06/central-asias-new-energy-giant-china/277338/>.
- ¹⁴ 2012 data is from the World Trade Organization statistics database. 2003 data is from China's General Administration of Customs.
- ¹⁵ Data from Eurostat. http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113457.pdf.
- ¹⁶ FDI data taken from UNCTADStat. For this data only, Central Asia is comprised of Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan.
- ¹⁷ Alexander Cooley, *Great Games, Local Rules: The New Great Power Contest in Central Asia* (New York, NY: Oxford University Press, 2012), p. 91; Jim Nichol, *Central Asia: Regional Developments and Implications for U.S. Interests* (Congressional Research Service, March 2014), p. 17. <https://www.fas.org/sgp/crs/row/RL33458.pdf>.
- ¹⁸ China National Petroleum Corporation, "CNPC in Turkmenistan." <http://classic.cnpc.com.cn/en/cnpcworldwide/kazakhstan/>.
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