Risk assessment and mitigation in Central Asia:
implications for foreign direct investment and the Belt and Road Initiative
1. Executive Summary

1.1. Introduction

Central Asia has many attributes as a destination for foreign direct investment (FDI), but it has long had a reputation as a difficult environment for foreign investors. Although the region’s extensive natural resources and markets do offer an attractive rationale for investment, and have led to significant capital investment, some companies have faced challenges with regard to the business environment. Gaps in infrastructure have also been problematic. Indeed, the predominant theme for many foreign investors in Central Asia has been one of risk, rather than reward.

However, two factors suggest that there is potential for positive change. First, important advances in Central Asian regional cooperation and economic growth have attracted the interest of a new wave of international investors. Second, the Belt and Road Initiative (BRI), and the associated growth of Chinese investment in Central Asia, have opened up new opportunities, as well as risks.

Central Asian countries, foreign investors and international development partners share common interests in understanding and mitigating risks in order to maximise their opportunities for successful investment and economic development.

1.2. Central Asia in transition

There are significant opportunities within the economies of Central Asia. The region faces changes in the international geopolitical order and its own socioeconomic transitions, as well as in energy and security relationships. Yet regional growth, at 4.6 per cent in 2018, is strong. While Kazakhstan, the Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan and Uzbekistan each pursue their own individual development paths, they share similar challenges with regard to national identity, close proximity to major powers, cross-border resource management, relatively high levels of poverty, underinvestment in sustainable infrastructure, and the challenges of economic diversification, job creation and growth. Russia remained for a long time the largest trading partner for the region. Over the past decade, however, ties with China have been strengthening.

1.3. The Belt and Road Initiative and Chinese investment in Central Asia

China’s Belt and Road Initiative is now in its fifth year of implementation. The land corridor of the BRI aims to link Asia and Europe through a network of railways, roads, pipelines and power grids. Central Asia is at the heart of the overland route, flowing through Xinjiang and including Mongolia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Uzbekistan and Turkmenistan, thereby linking China with the European Union (EU) and with the Arabian Peninsula via South Asia. Central Asian rail links are positioning themselves as alternatives to sea lanes and air transport, mainly for high-value, low-volume goods. The project’s scale is poised to create commercial opportunities in the region for a wide range of companies and service providers from around the world.

During the past fifteen years, the pace of economic cooperation – including trade – between China and Central Asian countries has increased exponentially in volume and scope, now involving financial, technical and cultural cooperation. At the regional level, Chinese investment has already triggered a positive process of regional integration, mainly in the area of logistics. Chinese investment in Central Asia has increased and diversified rapidly in recent years. The BRI is now moving towards broader economic cooperation, involving industrial and agricultural projects as well as power grids and the Digital Silk Road. Although domestic markets in Central Asia are small in comparison with those of the EU or Russia, they do provide some potential outlet for excess Chinese capacity in areas such as steel, cement and heavy construction machinery, as well as markets for technologically advanced information and communication technology networks.

Initially, the Chinese government, policy banks and state-owned enterprises took the lead with regard to investing in Central Asia. In some projects, state-owned enterprises (SOEs) benefited from Chinese policy banks’ inexpensive credit lines. However, the range of Chinese investors has grown over time to include many privately owned small and medium-sized enterprises (SMEs), with financing from a range of commercial banks and investment funds, both Chinese and international.
China is now the leading foreign investor in Central Asia, but the region also attracts significant investment from other Asian countries and from Europe. This is likely to continue. In all cases investors will face similar financial and non-financial risks; but there are also some “risks with Chinese characteristics”, which both Central Asian countries and Chinese investors have begun to understand and address.

1.4. Financial risks
The starting point for establishing the financial risk of an investment is an assessment of its economic viability. Willingness to repay is also critical. Both factors have been seen to present risks in Central Asian markets.

The bulk of historical FDI in Central Asia has been in natural resources extraction and hence global commodity prices have been a key factor. Costs are the other side of the economic equation and must be defined in the fullest sense, to include the costs of delays, bureaucracy and corruption. In the past, investments in extractive industries have been isolated from the domestic economy: the business environment has been less relevant than the project-specific terms that investors have negotiated with government counterparts. Yet as investments diversify, so do the factors affecting the ability to repay. The ability to conduct business effectively within the domestic market, and to export a wider spectrum of goods in new ways, becomes more critical. Foreign exchange volatility and economic downturns in export markets become important risks. And the business environment becomes more or less attractive depending on the nature and clarity of regulations, the ability to enforce contracts and laws impartially, the level of corruption, and the availability of reliable data to support business decision-making.

In countries where the enforcement of contracts and the rule of law are weak, repaying foreign investment becomes a “choice” alongside other possible uses for the same money. This choice depends in part on the importance attached to FDI in driving economic growth and prosperity in the country, and the need to maintain investor credibility. It also depends on the degree of popular support for or opposition to foreign investment, resulting from broad perceptions and experience of its impact. Moreover, governments may levy unplanned taxes, impose foreign exchange controls or simply argue that foreign capital is taking too much advantage of their country. Currencies may not be fully convertible due to the rationing of foreign exchange. In addition, government-to-government relations can play an important role in repayment. There is an added incentive to maintain reputation and trust within the context of a long-term geo-strategic relationship.

1.5. Non-financial risks
Faced with challenging and unfamiliar business environments, some companies prefer to take a narrowly financial approach, focused on cost and efficiency and seeking to avoid complications. This may make sense in the short and medium term, but is very likely to incur greater non-financial and financial problems later. For example, a heavy-handed approach to security can generate community resentment towards an investment, leading to opposition, especially if local job creation is lacking. Harmful and unremediated environmental impacts can also turn a local population against a foreign investor. In worst-case scenarios, poorly implemented foreign investment can result in increased tax bills, legal disputes and the cancellation of licences.

Addressing non-financial risks from the start can significantly reduce the overall financial risk of an investment. This means, for example, engaging early with local communities, taking preventive measures to reduce environmental impact and putting in place good governance and transparency measures to mitigate potential allegations of corruption.

1.6. Risks with Chinese characteristics
As China’s economic footprint has grown larger and more diverse, so too have the risks associated with it. Losses, financial litigation and legal disputes in foreign jurisdictions are becoming a common issue for an increasing number of Chinese companies. Many legal and financial problems relate to physical infrastructure and to workers’ security. Alongside the long-term impact on geopolitical relations, Chinese investments in the region have repeatedly come under the spotlight due to a perception that some have a negative impact on local communities, both environmentally and socially.

Risk factors may include the following:
• **Lack of knowledge of new markets**: China’s economic footprint has grown rapidly in Central Asia and around the world. With many Chinese market players relatively unfamiliar with external cultures and business environments, it is natural that there has been a sharp increase in the crystallisation of risks. Over time, with greater familiarity, the risks should abate.

• **Policy-driven investments**: In some cases, companies may have pursued investments for non-commercial reasons: for example, it is widely thought that some investments in the early years of the BRI were premised on a belief the investor could obtain political credibility and favour for supporting the BRI, regardless of the commercial risks. There is some evidence that this belief is now less prevalent.

• **Low-price bidding, with limited understanding of the risks to delivery**: Non-commercial targets and intense competition between SOEs may have driven some incidents of low-price bidding to win contracts. As the complexities of a project become clear, a company faces an unattractive choice between increased costs or “cutting corners” in a manner that will incur significant risk. When risks are not carefully identified at an early stage, hidden risks can be spread unpredictably across parties (government, contractor, bank, export credit agency). Evidence suggests that companies and the financial sector alike have tightened their approach to addressing this problem.

• **Organisational culture**: Chinese companies have an organisational culture formed within China, so it is normal that when they operate abroad they export some of China’s domestic reform challenges. These may include: environmental, social and governance compliance issues; a goal-oriented approach that underinvests in learning from experience; and a reliance on China’s central government as the ultimate insurance policy in all eventualities, including financial and security problems.

• **Limited financial support for smaller, private operators**: China has a broad range of external policy and commercial financing institutions and products. These, however, primarily support larger companies, especially SOEs. While their approach to risk mitigation may be strengthening, the significant and growing population of smaller Chinese private sector investors operating in Central Asia is relatively underserved, and is thus more exposed to facing market risks alone.

Ultimately, a narrow application of the “market approach with Chinese characteristics” meets certain limits outside the parameters of China’s own political economy. The diverse and specific conditions of doing business in Central Asia call for a robust approach to oversight and risk management of all kinds, incorporating the lessons of international best practice to mitigate financial and non-financial risks.
1.7. Mitigating risks

1.7.1. Developments in China’s risk management

China’s government has already made it very clear that it will not sustain underperforming investments. Recent years have seen an increase in the monitoring of overseas investment projects, with an explicit focus on anti-corruption campaigns and an emphasis on “quality investments”. Chinese companies have developed internal procedures to cope with more advanced risk mitigation, and have increased their engagement with insurers and multinational companies. China’s banks have also adopted more robust risk-management procedures and shown willingness to engage with international partners and learn from best practice.

Despite significant improvements, which are likely to be reflected in enhanced project quality in the years ahead, the approach to risk often remains focused on insurance (which can be costly) rather than on mitigation. The challenge, in considering the dimensions to risk mitigation that are set out below, will be to match the demand for sophisticated financing and insurance solutions that suit the needs of Central Asian countries with the distinctive business culture of Chinese firms.

1.7.2. Investment climate reforms in Central Asia

Perceptions of the investment climate vary widely across the region, but no country in the region can be characterised as low-risk.

- Kazakhstan and Mongolia achieved relatively high scores on the World Bank’s Ease of Doing Business Ranking for 2018 (36th and 62nd respectively). Uzbekistan was the fastest-improving country in 2018, at 74th.

- The ability to enforce contracts varies widely, from Kazakhstan (6th in the world), through Uzbekistan (39th) and Tajikistan (54th), to Mongolia (88th) and the Kyrgyz Republic (139th).

- Trading across borders is a challenge in all Central Asian countries. At the most extreme, Kazakhstan, which ranks as the region’s easiest place to do business, remains 123rd in the world in this regard. Uzbekistan ranks 168th and even the highest-ranking country in the region, the Kyrgyz Republic, is only 84th. There remains significant scope to improve cross-border trade and connectivity across the region.

- Corruption is a significant problem, with no Central Asian country performing particularly well in Transparency International’s Corruption Perceptions Index 2017. Mongolia ranks highest at 103rd, followed by Kazakhstan at 122nd. The remaining four countries range from 135th to 167th out of 180 countries.

- Financial sectors in all Central Asian countries are in relatively early stages of development, with Kazakhstan being by far the most advanced in terms of banking and capital markets alike. Kazakhstan is now implementing its stated ambition to become a regional financial centre for Central Asia, building on the recently launched Astana International Financial Centre. As investment diversifies beyond resources, and as intra-regional investment grows, a healthy financial sector will play a more important role.

A weak investment climate not only deters quality investment: it allows damaging investments to go ahead. As Central Asian countries build the institutions (in particular, the rule of law) and pursue the reforms necessary to do this, international organisations and development partners can provide assistance. It is also valuable to draw on the expertise of business, through structured discussion between governments and foreign investors. Most Central Asian countries have foreign investors’ councils or similar platforms for precisely this purpose, although so far Chinese investors have played a smaller role in these mechanisms than their economic weight would justify; their full participation could enhance both the expertise and the impact of these platforms, to address the region’s key reform priorities.

International development partners and investors have a strong interest in supporting the economic and social transitions of individual Central Asian countries, paying due regard to each national context, while encouraging continued intra-regional integration. In particular, they can support a specific focus on private sector development, rule of law, anti-corruption and ease of trading across borders within the region. This focus echoes clearly the Chinese government’s own domestic agenda: a commitment to complementary roles for state-owned enterprises and privately owned enterprises; strengthening of the rule of law; a fight
against corruption in all places, including when Chinese companies operate overseas; and a commitment to increased opening of the Chinese economy and the maintenance of the global trading system.

### 1.7.3. Detailed project due diligence

At the project level, companies can improve risk mitigation through a detailed, specific and holistic assessment of all risks from the outset, combined with a well-defined and ongoing risk monitoring process. These will include assessment and monitoring of the following: a financial assessment of revenues, investments and operating costs; a full evaluation of the project context; risks to the project relating to the business environment of the country involved; the project’s community and environmental impact; and security risks. Investing in these measures from the outset is worthwhile, bearing in mind the potential cost should a risk crystallise. However, a willingness to engage in detailed project due diligence has to be matched by expertise. Whereas foreign investors often bring strong technical expertise they may not have adequate understanding of or expertise in the local business environment, in which case they would do well to find a strong and reliable local or international partner, having first undertaken a robust risk assessment of that partner.

### 1.7.4. Higher investment standards

Higher investment standards – environmental, social and governance compliance standards as well as technical standards – cost more. But these costs are worthwhile to the extent that they limit non-financial risks, which can also crystallise as financial risks. Getting this right is important both for Central Asian countries and Chinese investors. Consistent implementation of national standards is the baseline that must be respected in project implementation. Beyond this, foreign investors can work with governments and financial institutions, including multilateral development banks (MDBs), to build consensus on best practice as they deliver high-quality investments with enhanced project-risk management. Approaching this at the project and company level – and through a risk-management lens – is as important as the setting of abstract, top-down guidelines and regulations.

### 1.7.5. Community engagement

Although foreign investment usually brings significant economic benefits to the investee country, these benefits are not always distributed in a socially sustainable way. When communities in proximity to a project fail to benefit or are negatively affected by the project, social and political risks of various kinds can crystallise, including – in the worst cases – a threat of violence. Latent prejudice against foreigners can also be a factor in these situations. Sustainable investment therefore requires a careful analysis of community impacts through a process of thorough and sincere community engagement that ultimately results in a project design that local communities can support.

### 1.7.6. Better data

Wang Yi, China’s Foreign Minister, has called the Belt and Road Initiative a “sunshine initiative” where everything will operate transparently and be open to all. Central Asia provides an opportunity to put this into practice. For example, this can mean close cooperation with other stakeholders in multilateral and commercial organisations, as well as with the relevant country government. Increasing the number of stakeholders, and sharing and agreeing on key information, form the basis for more objective risk assessment and mitigation.

Investor confidence would benefit from improved data standards, data collection and analysis to support improved credit, market and operational risk management and financial and business decision-making across the region. This could take the form, for example, of a regional credit bureau, designed and financed jointly by interested national governments, key foreign investor countries and appropriate international financial institutions. Improved quantitative tracking of security risks would also contribute to more realistic assessments of actual risk (versus perceptions of higher risk) and improve the ability to price and insure these risks. At the macro level, greater debt transparency would remove investor suspicion, a significant barrier to new investment.

### 1.7.7. Application of public-private partnerships

The use of public-private-partnerships (PPPs) as a risk-sharing mechanism has been growing in Central Asia. The application of an appropriate regulatory system in the region, aimed at improving transparency
and investor protection in the long-term financing of projects, will enhance funding availability. Importantly, it will also bring much-needed needed scrutiny and market efficiency.

China, too, has been actively promoting the role of PPPs since 2014, in order to enhance the financing options available for managing infrastructure project risks. Since the beginning of 2017, China has been actively promoting the use of PPP contracts in countries involved in BRI infrastructure projects. PPP projects along the BRI will involve government authorities, financial institutions, project investors and engineering, procurement and construction contractors. Cooperation between the public and private sectors will provide specific advantages, both in sharing financial burdens, and in design, construction, operation, management and maintenance. Implementation of the PPP model will provide positive externalities for BRI recipient countries and support their infrastructure funding. However, a lack of transparency in the application of the PPP model could negatively affect the debt structure of Central Asian countries, and perpetuate a lack of transparency about the economic attractiveness of BRI projects.

1.7.8. Multilateral partnerships

Central Asia, and investors in Central Asia, can benefit from partnerships with a broad range of international organisations and entities. These can provide various forms of expertise, finance, and risk-mitigation capacity. Among these international partners are multilateral development banks, the Shanghai Cooperation Organisation (SCO), and the European Union.

MDBs active in Central Asia include the Asian Development Bank, the Asian Infrastructure Investment Bank, the Eurasian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Islamic Development Bank and the World Bank. MDBs have a unique combination of attributes: a range of financing products; a relatively high appetite for risk; close links to shareholder governments; advisory and technical assistance functions; high-quality investment standards; and capacity to leverage international investors. While each MDB has its own specific strengths, individually and collectively they offer strong opportunities for countries and investors wishing to work according to their rules. Although Chinese contractors have worked on many MDB-financed projects, the number of direct Chinese investments financed by MDBs remains small relative to FDI from other countries.

The SCO includes, among others, most of the Central Asian countries as well as China. In recent years it has broadened its focus, from an initial emphasis on border security and counterterrorism, to become a multilateral organisation involved in economic and cultural cooperation. The SCO now includes an Interbank Consortium (IBC) as well as a Business Council. The SCO’s internal knowledge, organisation and capabilities in understanding, preventing and mitigating security threats could provide urgently needed knowledge to the insurance sector. The SCO IBC could become in this context an important financial integration platform in Eurasia.

The EU recently launched its Europe-Asia Connectivity Strategy, which China has welcomed as a complement to the Belt and Road Initiative. During 2019 the EU will also launch a new multi-year strategy for Central Asia. The EU approach focuses on transport, energy and digital connectivity, on the basis of international norms and standards. The key principles of the approach are financial, environmental and social sustainability, transparency, open procurement and a level playing field. The EU is willing to support partners in the Central Asian region who implement projects according to these principles, with a range of financial instruments that include technical assistance, grants and guarantees. As such, the EU can also play a key role in mitigating risks and enabling high-quality investments that create jobs and foster sustainable economic growth.
2. Investment risks in Central Asia

2.1. Economies and foreign direct investment in Central Asia

The scale and economic development of Central Asian countries is by no means uniform. Kazakhstan stands out as the largest economy and the richest in per capita terms. It relies heavily on hydrocarbon exports, such that its economy is heavily influenced by oil price fluctuations. It also has the world’s largest plutonium and second-largest uranium reserves. These resources, combined with a strong and ambitious government, have made Kazakhstan by far the largest recipient of foreign direct investment (FDI) in the region.

At the other end of the regional development scale, the Kyrgyz Republic is a very small economy, heavily dependent on remittances from Kyrgyz migrants working predominantly in Russia. With limited development in mining (apart from gold) it has attracted little FDI. Tajikistan, also with a small population and low per capita GDP, has attracted even less, though recent Chinese investments are changing the picture.

Table 1: Overview of economies and investment, 2017

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<tbody>
<tr>
<td>Kazakhstan</td>
<td>159</td>
<td>18.0</td>
<td>8,833</td>
<td>4.6</td>
<td>3%</td>
<td>147.1</td>
<td>9.3%</td>
</tr>
<tr>
<td>Kyrgyz Republic</td>
<td>8</td>
<td>6.2</td>
<td>1,226</td>
<td>0.1</td>
<td>1%</td>
<td>5.5</td>
<td>72%</td>
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<tr>
<td>Mongolia</td>
<td>11</td>
<td>3.1</td>
<td>3,548</td>
<td>1.5</td>
<td>14%</td>
<td>18.0</td>
<td>164%</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>7</td>
<td>8.9</td>
<td>787</td>
<td>0.1</td>
<td>1%</td>
<td>2.6</td>
<td>37%</td>
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<tr>
<td>Turkmenistan</td>
<td>42</td>
<td>5.8</td>
<td>7,241</td>
<td>2.3</td>
<td>5%</td>
<td>34.2</td>
<td>81%</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>49</td>
<td>32.4</td>
<td>1,512</td>
<td>0.1</td>
<td>0%</td>
<td>9.3</td>
<td>10%</td>
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Uzbekistan has the largest population and the second-largest economy in the region. Until recently it has been quite closed, attracting limited FDI. However, the country has embarked on a comprehensive economic reform programme, which promises to attract large FDI inflows from a range of investors over the coming years.

Turkmenistan remains a very closed economy. Despite this, the attraction of its very large gas reserves means that FDI from China has been significant. The investment has, however, been concentrated overwhelmingly in gas production and gas pipelines backed by Chinese investors.

Lastly, Mongolia has the highest ratio of FDI stock to GDP. This reflects the combination of a small, relatively poor population and the country’s extensive reserves of copper, gold and coal.

2.2. Framework for assessment of risks

State-owned and private foreign investors alike face many similar and often-intertwined investment risks across Central Asia. These include:

- overall macroeconomic, political and security risks
• risks and challenges in operating the business itself, including: ease of doing business; regulatory burdens; government intervention; ability to enforce laws and contracts; the independence of the judiciary; the availability of reliable data for business decision-making; and corruption
• risks in securing financing locally or from the impact of financial sector instability
• environmental and social impact risks
• particular risks for foreign investors, such as political sensitivities, resistance to foreign involvement, and regulatory barriers to foreign ownership and access, and
• foreign exchange and repatriation risks, based on currency convertibility and exchange rate volatility.

In order to determine which of these are more or less important, and to understand inter-linkages, it is helpful to distinguish between financial and non-financial risks. Thereafter it is important to explore how non-financial risks generate further financial risk.

Financial risk at its simplest is the risk that investors will not get their money back, nor earn the expected return on investment. This risk can be broken down into (i.) the ability of the recipient to repay the investment and (ii.) their willingness to do so.

Non-financial risks at their most basic include, for example, risks to human life and physical property. Other important risks to consider are environmental and climate impacts as a result of increased carbon emissions, cyber risks, and disease – for example, pandemics caused by greater connectivity and danger of contagion.

The starting point for establishing the financial risk of any investment is its economic viability. For the bulk of historical FDI in Central Asia – that is, investment in natural resources extraction, or the infrastructure required to move the extracted resources – global commodity prices (or the price that the consuming country is willing to pay) have played a major role in the economic viability of investments. This brings into play the risks inherent in commodity cycles.

Naturally, the costs required to secure the revenue are part of the economic equation. They need to be defined, in the fullest sense, including the cost impacts of delays, bureaucracy and corruption. As a result, there is significant economic risk to project viability.

Historically, investments in countries as different as Mongolia and Turkmenistan have been largely isolated from local business activities, with limited links to the domestic economy – although the resources boom has created demand in related services. This has meant that the health of the domestic business environment has been of less direct relevance than the project-specific terms negotiated by investors with government counterparts.

As investments diversify, in part based on demand created by the extractive sectors, or as part of explicit government policy to diversify the economy away from resources, the key factors affecting the ability to repay change. The ability to conduct business effectively within the domestic market, and to export a wider spectrum of goods in new ways, becomes more critical. Trust and transparency regarding a broader and more diverse range of business counterparties also becomes more important. This means that the domestic business environment and – for export-related investments – the ability to trade smoothly and easily across borders play a much more important role. The business environment becomes more or less attractive depending on: the nature and clarity of regulations; the ability to enforce contracts and laws impartially; the level of corruption; and the availability of reliable data to support business decision-making.

Beyond the economic viability of investment, willingness to repay is also a critical factor. In countries with weak enforcement of contracts and rule of law, repaying foreign investment becomes a ‘choice’ alongside other possible uses for the same money. Politically, choosing to direct the same sums of money towards the local population may be a more attractive option. This will depend in part on the importance attached to FDI in driving economic growth and prosperity in the country, and thus the need to maintain investor credibility.

It will also depend on the degree of popular support or opposition to foreign investment, resulting from broad perceptions and experience of its impact. Concerns about the environment come to the fore when resource extraction is the focus.

Even where a project cannot demonstrate clear economic viability, the ability to repay can still be assured by the government by using other resources and assets at its disposal. This makes investment risk dependent to some extent on the fiscal position of the government – even if the investment was not
initially financed by government at all. Governments in a weak position may seek to levy unplanned taxes on successful foreign investment; impose foreign exchange controls to prevent repatriation of profits; or simply argue that foreign capital is taking too much advantage of that country. Currencies may not be fully convertible due to rationing of foreign exchange, as in Turkmenistan. In the most difficult economic conditions, this might not even be a policy choice; the lack of foreign exchange could mean that effective repatriation of profits and investment is closed off.

Equally, government-to-government discussions and the state of bilateral relations play a critical role in repayment. There is an added incentive to maintain reputation and trust within the context of a longer-term geo-strategic relationship which is not open to corporate private investors acting alone. In both the Kyrgyz Republic and Tajikistan, governments have intervened to ensure a Chinese state-owned enterprise received payments for investments that it had made, despite domestic difficulties.

This leads back to non-financial risks. Where foreign investment generates – or is perceived to generate – significant external problems, there will be increased social and political resistance to repayment. Detrimental environmental impact, lack of engagement with and understanding of local communities, property expropriation and insufficient local job creation all contribute to negative views on foreign investment. This reduces the likelihood of repayment. Meanwhile, such negative local reaction, coupled with increased security risks, make investment less attractive to foreign investors and lead to a decrease in expected returns as a result of increased risk premiums.

Political and criminal violence can be a feature of the investment environment, generating additional costs and risks. While attention focuses most often on terrorist threats in the region, theft, property damage and criminal violence related to drug-trafficking are in fact more common. Moreover, while kidnapping for ransom and extortion is an infrequent occurrence in urban areas, there is higher risk of this in more remote zones. Terrorist threats and spillovers of political violence are highest close to the Afghan and Pakistan borders.

Corruption can also generate further financial risks, where pressure from civil society and changes in leadership can lead to re-examination of alleged corrupt payments. Allegations related to anti-corruption campaigns can be used as instruments for business ‘reshuffling’ and lead to abrupt changes of business partners.

Addressing non-financial risks from the start can therefore significantly reduce the overall financial risk of an investment. This means, for example, engaging early with local communities; taking preventive measures to reduce environmental impact; and putting in place good governance and transparency measures to mitigate later potential allegations of corruption. Such measures can be introduced as a condition when drawing on third-party financing.

2.3. Comparison of risks across countries

While foreign investment across Central Asia encounters similar types of risk in each country, the specific risk profiles and risk levels vary – but no country can be considered a low-risk investment environment.

At the overall level of sovereign debt risk, only Kazakhstan was rated in 2017 by Moody’s as investment grade (Baa3). The other countries were non-investment-grade (B2 or B3), with the rating process for Uzbekistan currently underway. On 20 and 21 December 2018, S&P and Fitch assigned first-time sovereign ratings for Uzbekistan. Both agencies assigned a rating of “BB-, stable outlook”.

Political stability also varies, and must be carefully defined. Kazakhstan benefited from the stability of Nazarbayev’s rule and a focus on investment attraction and reform, while questions linger about what may unfold now that his leadership has ended. Meanwhile, the risk of change in the political climate, while present, is often overrated. Recently, two cases of power transition, in Turkmenistan (2007) and in Uzbekistan (2016), wrong-footed several political scientists who had forecast instability during ‘father of the nation’ successions. In the Kyrgyz Republic, policy has remained relatively stable despite frequent changes in the office of prime minister. However, businesses report that quickly changing administrations and regulations cause additional costs and delays.

The business environment varies widely too. Kazakhstan and Mongolia score quite highly on the World Bank’s Ease of Doing Business Ranking for 2018 (36th and 62nd respectively). Uzbekistan was the fastest-improving country in 2018, now at 74th; the Kyrgyz Republic is at 77th. At 135th, Tajikistan languishes near the bottom of the 190 countries, while Turkmenistan is not even ranked.
Specific problems vary across countries – for example access to credit, and the ease of starting a business. Access to electricity is a significant challenge in the Kyrgyz Republic, Mongolia and Tajikistan. Domestic credit is less of an issue, except in Tajikistan. The ability to enforce contracts also varies widely: from Kazakhstan (6th in the world), through Uzbekistan and Tajikistan (39th and 54th), to Mongolia and the Kyrgyz Republic (88th and 139th). These rankings reflect weaknesses in the quality of institutions – in particular, of the rule of law.

Notably, trading across borders is a challenge in all Central Asian countries: at the most extreme, Kazakhstan, which ranks as the easiest place to do business in the region, still ranks 123rd in the world in this regard. Uzbekistan ranks 168th and even the highest-ranking country in the region, the Kyrgyz Republic, is only 84th. There remains significant scope to improve cross-border trade and connectivity across the region.

Corruption is a significant problem, with no Central Asian country coming out particularly well in Transparency International's Corruption Perceptions Index 2017. Mongolia ranks highest at 103rd, followed by Kazakhstan at 122nd. The remaining countries range from 135th to 167th out of 180 countries.

Financial sectors in all Central Asian countries are in relatively early stages of development, with Kazakhstan being by far the most advanced in terms of both banking and capital markets. Kazakhstan is now implementing its stated ambition to become a regional financial centre for Central Asia, building on the recently launched Astana International Financial Centre. While banking sectors in each country need to develop risk management capabilities and raise the quality of banking supervision, this has not played a critical role for resources-based foreign investment to date. However, as investment diversifies beyond resources, and as intra-regional investment grows, a healthy financial sector will play a more important role.

Across the region, foreign investors are exposed to the risk of weakening exchange rates that might depreciate the dollar value of their investments, especially if only a small proportion of revenue streams is denominated in dollars. Capital controls in Tajikistan and Turkmenistan are tight and constrain foreign investment. The large devaluation of the Uzbek som, and the move to convertibility, did however remove a major barrier to foreign investment.

2.4. Assessment of security challenges: From terrorism to criminal violence and cybersecurity

Other non-traditional risks are significant and often overlooked. For example, criminal violence can create long-term liabilities in terms of damaged equipment, theft, and physical risk to personnel. As mentioned, kidnapping for ransom and extortion are rare in urban areas, but a present risk in more remote zones. In this respect, the proximity of the Kyrgyz Republic and Tajikistan to Afghanistan and Pakistan means that they suffer from negative spillovers of the longstanding conflicts, as well as serving as a route for narcotics smuggling to the European Union (EU) and Russia. Natural disasters and interstate disputes about water use rights complete the risk map.

In Central Asia the threat from terrorism is remote but still present. Kazakhstan and Mongolia are at the lowest levels of regional terrorism risk perceptions. At the opposite end of the scale, the Kyrgyz Republic and Tajikistan face higher risks due to borders that are relatively porous. Turkmenistan has devoted significant effort to strengthening its border to contain the Taliban and prevent infiltrations from those affiliated to ISIS in northern Afghanistan.

The Silk Road Economic Belt (SREB) land route encompasses a wide array of non-traditional security issues. Some areas in Central Asia are exposed to ethnic and religious tensions. In order to achieve safe, stable and sustainable development in Central Asian countries, the broader spectrum of political and criminal violence has to be considered, while being careful of bias and perceptions that are not based on evidence.

While the terrorist threat is still a relatively minor issue, the SCO has warned of the movement of extremist groups across borders in South and Central Asia. Nevertheless, thanks to Uzbekistan’s new foreign policy and the recent progress in border agreements, the uncertainty caused by the substantial geopolitical transformation of Europe and Asia is only partially affecting the size and speed of FDI in the region.
2.5. Cybersecurity: a crisis in the making

One common feature regarding risk appraisal in Central Asia relates to the general lack of interest in cybersecurity from the standpoint of foreign investors.

Many believe that only highly connected and technology-driven economies need to address this specific threat. In fact, cyber disruption can generate costly delays for projects, or even cause their complete failure in most types of situations. From the Chinese standpoint, investments in the energy sector and the need to merge local data networks during mergers and acquisitions with Chinese SOEs increase vulnerabilities. From day one, foreign investors in the region need to establish sound cybersecurity protocols in order to avoid dangerous and costly data breaches.

During both acquisition and greenfield investment the lack of a proper cybersecurity assessment and failure to develop effective defensive capabilities may create an easy target for hackers with criminal or political agendas. Attacks following ransomware requests or data breaches that are made public reduce the value of investment assets. The new Chinese Cybersecurity Law is very specific on the penalties for both state-owned and private companies for breaches and loss of data that could involve state secrets. Risk assessment in the cyber-realm is not only an issue for the information and communication technologies (ICT) sector: it is relevant for all investments in the region. As Central Asian countries digitalise their economies, cybersecurity challenges increase proportionally.

Given this, risks and cost can be factored into the broader risk assessment by understanding several key risk indicators (see Box 1).

<table>
<thead>
<tr>
<th>Box 1: International risk factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Current cybersecurity capability, compatibility and vulnerabilities</td>
</tr>
<tr>
<td>• Previous attacks and current cyber threats</td>
</tr>
<tr>
<td>• Source, amount and nature of digital assets to be protected</td>
</tr>
<tr>
<td>• Compliance with regulations of home and host countries, and with global regulations</td>
</tr>
</tbody>
</table>

Cyber protection, by nature, is dynamic and constantly evolving according to technological, social, economic and geopolitical changes. This creates a need for adequate financial and human resources. Failure to comply could lead to even more costly negative outcomes. Nonetheless, too few local governments and international investors are addressing the threat effectively. Leading the field is Kazakhstan’s “Cyber Shield”, a system which aims to prevent and mitigate cyber-attacks, with implementation due by 2020. The Kazakh approach to cybersecurity is of relevance for the other Central Asian countries, as the system not only addresses national security, but also encompasses the business community and the cybersecurity of foreign-invested companies. In this respect “Cyber Shield” aims to promote a safe business environment, protecting not only the state’s core cyber functions, but also the local and international business community against cyber threats. Once operational, the Kazakh cybersecurity platform could become an example of best practice for the wider region.

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3. China's investments and approach to risk in Central Asia

3.1. China and the Belt and Road Initiative in Central Asia

The Belt and Road Initiative is a signature foreign policy priority of Chinese President Xi Jinping and is now enshrined in the constitution of the Chinese Communist Party. The BRI consists of two aspects: the SREB, a land route starting in western China that goes through Central Asia and on to the Middle East, with its terminus in the EU; and the 21st Century Maritime Silk Road, a series of maritime routes that connect South-east Asia, the Middle East and southern Africa and also end in the EU.

While China and Russia play a prominent role in Central Asia, Turkey, India, Pakistan and Iran are intensifying their influence thanks to historical, cultural and linguistic ties. These roles are changing, however, as China becomes a highly significant economic and geopolitical player in the region. The traditional view of Russia being in charge of regional security, with China the main economic actor, is outdated and being challenged by a more assertive Chinese stance. Meanwhile, Russia remains a major economic force in Central Asia, alongside the growing economic interdependence with China.

The Belt and Road Initiative is now in its fifth year of implementation. So far, China's economic strategy has been characterised by infrastructure projects, and by hydrocarbon and mining resources extraction financed by state banks in emerging markets. However, the strategy is now more diversified, with an increasing focus on the agribusiness and industrial sectors and a growing proportion of private sector investment from China.

The land corridor of the BRI aims to link Europe and Asia together via a network of railways, roads, pipelines, and power grids. Central Asia is at the heart of the overland route, originating in Xinjiang and crossing Mongolia, Kazakhstan, Kyrgyz Republic, Tajikistan, Uzbekistan and Turkmenistan, thereby linking China with the EU and the Arabian Peninsula via South Asia. While the sea corridor of the BRI is also expanding rapidly, the Central Asian rail links are positioning themselves as an alternative to sea lanes and air transport, mainly for high-value, low volume goods. The project's scale is poised to create commercial opportunities in the region for a wide range of companies and service providers from around the world. In summary, Central Asia is of paramount importance in the long-term success or otherwise of the BRI. It was not by chance that in 2013 President Xi first announced the vision of Belt and Road during a speech at the Nazarbayev University in Kazakhstan.

The first BRI projects (although not so named at that time), focusing on the exploitation of natural resources, started in Central Asia. Some have faced difficulties due to social unrest, environmental degradation and a general lack of corporate social responsibility (CSR) and governance oversight. These experiences have helped to identify improvements for further projects. The lessons that Central Asian countries have learned from their early involvement in the BRI can have relevance elsewhere.

This said, the economic development paths that each Central Asian country is pursuing are still dominated by a heavy government presence, with the exception of the Kyrgyz Republic and Mongolia. Bilateral trade between China and its Central Asian neighbours balances the flow of oil, gas and metals to China with a counter flow of direct investments and Chinese goods to the region. Although Chinese outward direct investment (ODI) has surged worldwide, Central Asian countries remain an important part of Beijing's investment policy. Chinese investment into Central Asia has increased and diversified rapidly in recent years. While in terms of BRI investment volume Central Asia attracts a smaller part of Chinese FDI, the relevance of the corridor-building over the continent remains significant. Examples of investments include connectivity projects such as the operational freight railway corridor linking China with the EU via Almaty-Khorgos (Kazakhstan) and two other planned rail corridors. Brownfield and greenfield investments include the Chinese ICT groups Huawei and ZTE's assembly plants in Uzbekistan, the logistic hub in Khorgos, a steel plant in Tajikistan, and the Kara-Balta oil refinery by Shaanxi Coal and Chemical Group in the Kyrgyz Republic.

The interdependence between China and several Central Asian countries started before the BRI with China's energy imports, evolving later on into infrastructure and connectivity projects with Beijing as a major lender. While some countries along the BRI ponder the strategic implications of these Chinese
investments, Central Asian countries perceive Chinese infrastructure projects as a business opportunity, while aiming to preserve their own economic systems and distinctiveness. Beijing's efforts in Central Asia have not only provided a platform for further economic development and integration but also increased global interest and attention in the region. Central Asian countries are influenced by their geographic landlocked configuration, with Uzbekistan being one of only two countries in the world that are doubly landlocked. With limited logistic infrastructure and lacking access to open seas, these countries view the BRI as a way to build connectivity and so to overcome the development limits caused by difficult access to foreign markets.

The main energy corridors across the region are the Kazakhstan-China oil pipeline and the Central Asia-China natural gas pipeline. Both pipelines have expanded significantly over recent years, since 2003 and 2009 respectively. In 2017, the Kazakhstan-China pipeline carried 12.3 million tonnes of oil and 44 billion cubic metres of natural gas, while the Central Asia-China natural gas pipeline carried 34 billion cubic metres of natural gas in 2016.

The BRI is now moving towards broader economic cooperation, involving industrial and agricultural projects as well as power grids and the Digital Silk Road. Although domestic markets in Central Asia are small in comparison with the EU or Russia, they do provide some potential outlet for excess Chinese capacity in areas such as steel, cement and heavy construction machinery, as well as markets for technologically advanced ICT networks.

However, as the Chinese economic footprint becomes larger and more diverse, so too do associated risks. Losses, financial litigation and legal disputes in foreign jurisdictions are becoming a common issue for an increasing number of Chinese companies. Many legal and financial problems relate to the physical infrastructure itself and workers’ security. Alongside the long-term impact on geopolitical relations, Chinese investments in the region have repeatedly come under the spotlight as a result of their perceived negative impact on local communities, both environmentally and socially.

Primarily, it is the Chinese government, associated banks and state-owned enterprises who take the lead in overseas investment strategy. SOEs benefit from Chinese policy banks’ inexpensive credit lines, and are supported by Chinese and foreign private companies acting as subcontractors. Early investments by state-owned Chinese energy companies have been followed by other state enterprises such as China Railway Construction Corporation, China Communication Construction Corporation, China Merchants Holdings International, China General Nuclear Power Corporation and China State Grid International Development.

However, credit has been tightening in the Chinese financial system, both for domestic and international reasons, reducing the availability and raising the price of credit from Chinese banks, be they commercial or policy banks. This has contributed to a slowing of BRI investments while also enhancing the appetite for solutions from MDBs and other local and international sources of finance.

At the multilateral level, several IFIs are increasing their footprint in the region, including the Asian Development Bank, the EBRD, the European Investment Bank, the International Monetary Fund (IMF) and the World Bank. In addition, two new multi-lateral organisations, the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB), are providing financial support to regional development. Depending on structuring, multilaterals can provide additional funding as well as competition and cooperation with the Chinese state lenders, from policy lenders such as the Export-Import Bank of China (EXIM Bank) and the China Development Bank (CDB) to international commercial banks such as Bank of China (BoC) and the Industrial and Commercial Bank of China (ICBC).

3.2. Chinese FDI in Central Asia

China’s emergence as a leading foreign investor in Central Asia represents a change in the historic role of Russia in the region. Nevertheless, the region is still affected by the industrial and economic legacy of the Soviet Union. It is notable, however, that China does not at this stage occupy the leading position in the two largest economies, Kazakhstan and Uzbekistan. In Kazakhstan, this reflects the strength of Western investment in resources, from investors registered in the Netherlands, the USA, the United Kingdom (UK), Switzerland and France. By contrast, in Uzbekistan, it is the historic strength of Russian investment that dominates. In the smaller economies of Tajikistan and the Kyrgyz Republic, China has the upper hand – as it does in the closed economy of Turkmenistan, due to its gas interests. China has played a large role historically in Mongolian foreign investments. In recent years, Mongolia has often favoured Western, Japanese and South Korean investors in order to diversify its economic connections to neighbouring
countries as part of its “Third Neighbour” policy. However, China remains by far Mongolia’s largest trading partner.

China’s position as a foreign investor will strengthen overall as a result of Belt and Road investments, and will also diversify to a broader range of industries. But, while China is likely to remain the largest source of FDI in the region, there will continue to be FDI from other regions too. No matter where investors come from, they will face the same opportunities and challenges in the business environment.

<table>
<thead>
<tr>
<th>Country</th>
<th>China rank in share of FDI stock</th>
<th>China share of total FDI stock (%)</th>
<th>Russia share of total FDI stock (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kazakhstan</td>
<td>4</td>
<td>7%</td>
<td>3%</td>
</tr>
<tr>
<td>Kyrgyz Republic</td>
<td>1</td>
<td>27%</td>
<td>21%</td>
</tr>
<tr>
<td>Mongolia</td>
<td>1</td>
<td>27%</td>
<td>2%</td>
</tr>
<tr>
<td>Tajikistan</td>
<td>1</td>
<td>43%</td>
<td>17%</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>3</td>
<td>15%</td>
<td>34%</td>
</tr>
</tbody>
</table>

Source: KPMG report for the EBRD (see footnote 26) and authors’ calculations.
Note: Data are not available for Turkmenistan.

3.3. The experience of Chinese investment in Central Asia – country by country

The experience of Chinese investors across Central Asia is similar in most respects to that of investors from other countries. Yet there have been greater concerns about the perceived lack of local job creation by Chinese investors, coupled with geopolitical worries about over-dependence on China. This has been particularly salient in Kazakhstan and Mongolia.

3.3.1. Kazakhstan

Kazakhstan is the key focus of China’s political and economic activities in Central Asia, with the main expression of this being the Belt and Road Initiative. The current investment focus is on the energy sector: China National Petroleum Corporation has invested over US$ 12 billion in local oil and gas production, and around US$ 6 billion in pipelines to China. Sinopec, CITIC and China Investment Group are also significant investors. Investment is now expanding to chemicals, manufacturing, agriculture and other industries. Overall, there were more than 500 joint ventures (JVs) and more than 9,000 companies with Chinese equity by 2016. In 2017, the government announced 51 new joint projects in chemicals, mining and other sectors, to the value of US$ 28 billion.

Chinese investors face similar challenges to those from other countries, including a sometimes-demanding regulatory environment and corruption. There is some additional local concern about whether and when Kazakhstan will recover lands rented to Chinese companies when the leases expire, and about inadequate local job creation.

China, like other investors, finds ways to counteract these challenges through high-level liaison, and using project-specific incentives and agencies.
3.3.2. Kyrgyz Republic

Given the Kyrgyz Republic’s border with China’s Xinjiang province, security considerations have historically played a more important role in China-Kyrgyz relations than economics and investment. This has changed as Chinese trade has increased; it is now a significantly larger trading partner than Russia. China is also the largest foreign investor, despite total Chinese FDI of only US$ 2 billion as of 2016, while China accounts for over 4 per cent of Kyrgyz foreign debt. Manufacturing is the main sector for investment, given relatively limited resource assets, with the Chinese government suggesting the relocation of capacity from China to take advantage of lower costs. KPMG identified 19 ongoing and planned projects from local media, the largest being the Kyrgyz part of the Turkmenistan-China gas pipeline.

China faces challenges similar to other investors in the Kyrgyz Republic: corruption, weak rule of law, frequent changes of government, a low level of transparency, and potential for public demonstrations against the behaviour of foreign investors. There is particular concern that Kyrgyz citizens are not employed sufficiently at Chinese-invested companies. For example, Chinese workers were sent back to China following local protests at a gold concentration mill at the Taldy-Bulak-Levoberezhnyi field.

Tebian Electric Apparatus (TBEA) has also encountered problems following an accident at a thermal power plant in Bishkek that it modernised, leading to local Kyrgyz calls on the government not to repay the debt incurred by the project.

3.3.3. Mongolia

China is the leading investor in Mongolia, accounting for a third of all investment, and is its main export destination, with more than 90 per cent of Mongolian exports going to or through China. More than 7,000 Chinese companies operate in Mongolia, covering both mining and construction, and wholesale and retail sectors. Within the BRI, Mongolia forms part of the proposed “China-Mongolia-Russia” corridor.

Initial major investments were made during the boom a decade ago, via resource companies such as Shenhua and PetroChina. A fear of Chinese dominance, however, led to the government blocking them from investing in the largest projects, such as Tavan Tolgoi (a coal mine) and Oyu Tolgoi (a copper and gold mine).

Now, as commodity prices and related investment are recovering after a collapse, KPMG has identified 12 projects from available data, worth US$ 9.6 billion. These are mainly in power generation (for example Buuruljut power station, Erdenet thermal power plant expansion) and transport (for example Erdenet-Ovoot railroad, Regional Road Development Project).

History, and the scale of Mongolia’s links to China, mean that local concerns about China are greater than in other Central Asian countries. There are concerns about excess dependence, loss of autonomy, Inner Mongolia’s competitive role in cashmere production, the role of Chinese small businesses in the economy, and environmental impacts. For example, the Egiin Gol hydropower plant construction was placed on hold following concerns raised by Russia about the ecological impact on Lake Baikal. The fact that Mongolia only gained independence from China in 1921 adds to the salience of these concerns, and has led to the explicit exclusion of Chinese companies from some projects.

3.3.4. Tajikistan

China first invested in Tajikistan about 10 years ago, but is now the largest investor, focusing on manufacturing and natural resources. Early investments included a gold mine in the north of the country by Zijin Mining. By 2016, China accounted for 72 per cent of FDI, far ahead of Russia at 7 per cent, and had a total FDI stock of around US$ 1 billion.

The two flagship projects are (i.) China National Heavy Machinery Corporation’s joint venture (CNBM-TALCO) to construct an alumina refinery and (ii.) the CNPC Joint Venture, the Trans-Tajik Gas Pipeline Company, creating Tajikistan’s part of the Turkmenistan-China natural gas pipeline. KPMG identified 24 China-Tajikistan projects completed after 2012, around two-thirds of which were in cement: Tajikistan’s relatively weak environmental enforcement creates significant environmental challenges.

Even as the leading foreign investor, China has experienced the same challenges as other investors, including non-payment, corruption and insufficient protection of property rights.

Larger problems of non-repayment have been resolved through government-to-government discussions. China’s Tebian Electric Apparatus (TBEA) company was contracted for US$ 332 million to build two...
combined heat and power plants in Dushanbe which opened in 2012, and reached full capacity in 2016. It encountered repayment problems, which have been resolved by Tajikistan’s president granting TBEA the rights to two gold mines until it has recouped its investment.

Previously, in 2011, Tajikistan ceded to China 1,100 square kilometres of strategically positioned land with gold and uranium deposits along the Wakhan Corridor, and also allowed Chinese farmers access to scarce arable land. This has been rumoured to be in exchange for hundreds of millions of dollars in debt relief.

In June 2018, China agreed a further US$ 200 million mining venture between Tibet Huayu Mining and Tajikistan’s state-owned aluminium company, Talco, to produce gold and antimony in a joint venture.

3.3.5. Turkmenistan

China’s investments in Turkmenistan are shaped by its position as the largest buyer of the country’s gas, the biggest source of national revenue. The construction of the Turkmenistan-China gas pipeline is the largest foreign investment project in the country, though only limited details are public. As a result, China is the largest foreign investor in the country, with investments of US$ 17 billion as of 2016. Reports indicate a total of around 40 Chinese companies operating there in the oil and gas sectors, as well as telecommunications, transport and textiles. KPMG identified debt and equity financing worth US$ 26 billion, mostly credit facilities of around US$ 20 billion connected to the gas pipeline, and development of the Galkynysh gas field. In September 2018, China and Turkmenistan also discussed the potential for development of tourism there as part of the BRI.

China faces the same challenges as other foreign investors in Turkmenistan, a closed country with a non-convertible currency. The difference is that the strategic importance of China as a customer and geo-strategic actor gives China greater leverage to arrive at manageable solutions. There are similar, local concerns about job creation for citizens of Turkmenistan and about environmental impact, although these have few outlets within the country’s political system.

3.3.6. Uzbekistan

Uzbekistan has become an important investment partner for China, especially regarding natural gas, uranium and transport links. Since 2015, China has been Uzbekistan’s largest source of foreign investment in infrastructure, and second-largest trading partner. As of 2016, there were more than 600 Chinese-invested companies in Uzbekistan. KPMG identified Chinese investment in 31 projects in 2012-17, with the greatest data availability of any Central Asian country. Investment is increasingly moving from infrastructure and energy towards natural resources, chemicals and manufacturing. In 2017, Uzbekistan announced that it was signing around 100 agreements with China, worth around US$ 20 billion in the context of the BRI.

China faces similar challenges in Uzbekistan to other foreign investors: unclear competences of government institutions, corruption, and poor infrastructure in places. In addition, there is some local concern with inadequate local job creation, and around gas exports to China depriving the domestic market of supplies.

3.4. Approach to risk management for Chinese SOEs in Central Asia

With the momentum of the BRI, China is positioning itself as the world’s leading provider in construction and financing of infrastructure. China’s project contracting in Central Asia is steadily progressing and evolving in different sectors beyond natural resources. The complexity of the projects involved is growing in parallel with the frequency and severity of risks.

Risk management is commonly regarded as the process of identifying, assessing and managing the effect of uncertainty on a project through the economical application of resources to monitor, minimise and control the probability and the impact of unfortunate events and maximise the opportunities. In addition to the usual risks examined previously, there are certain additional ‘risks with Chinese characteristics’ (see Box 2).
While acknowledging these risks, Chinese SOEs have a tendency to blur the lines between commercial and political dynamics due to their ‘market approach with Chinese characteristics’. Ultimately, SOEs take for granted Chinese government support in any kind of crisis, ranging from financial bailouts, to security support for employees. This behaviour is rooted in decades of state-led corporate culture; the result is a widespread lack of oversight and risk management of all kinds: financially, operationally and in terms of political, security and criminal risks.

Beijing exercises supervisory rights over China’s SOEs through the State-owned Assets Supervision and Administration Commission of the State Council, which in 2011 produced new risk control measures. There is a common perception that the relationship between Beijing and the SOEs is exclusively top-down, with the Chinese government imposing guidelines and the SOEs following. But although Beijing maintains a supervisory role via SASAC, the National Development and Research Commission (NDRC) and the State Administration of Foreign Exchange (SAFE), most of the decision-making power remains within individual SOEs. As a result, SOEs are not only able to develop their independent overseas investment strategies, but also influence the Chinese government in shaping international policies. The latest anti-corruption efforts and the change of the top management in several leading SOEs aim to counterbalance this trend.

Nonetheless, China’s government has already made it very clear that it will not sustain underperforming investments. In the past decade, Chinese SOEs have developed internal procedures to cope with more advanced risk mitigation, but Chinese small and medium-sized enterprises are still struggling to cope with the complexity and costs of risk management.

Beijing has already promoted the evolution of a legal and regulatory system related to ODI financial risks in light of the new risks and security needs. China’s NDRC defines in detail the conditions for overseas investment in the document on “Interim Authorization Criteria for Overseas Investments” (2004), but the security threats that Chinese SOEs will to face in Central Asia will require broader engagement (see Box 3).
Due to the unique characteristics of how Chinese SOEs operate, there is strong demand for risk experts who are able to bridge the gap between Chinese business culture and attitudes to risk and international requirements.

One pillar in risk assessment and mitigation in Central Asian projects relates to the requirements for project financing approval. Central government reforms in this area are aimed at avoiding unnecessary financial exposure, non-performing loans and undesired political spillovers. Unfortunately, some Chinese banks have less restrictive requirements for SOE project financing compared to private sector-led projects. Chinese state-owned banks may adopt different risk management standards when putting geo-strategic considerations alongside economic returns.

3.4.1. Cooperation with global insurers and IFIs

In order to apply these risk mitigation tools, Chinese insurers are following their clients overseas, but suffer – just as their clients do – from a lack of previous international exposure and experience.

The most obvious way to mitigate this is through cooperation with reinsurance companies and IFIs. One insurance expert states that “China has been the growth engine for many reinsurance companies in terms of premium income, but not necessarily in terms of profit”. While Chinese domestic insurers compete aggressively in the offer of standard insurance products, multinational insurers and reinsurers offer sophisticated insurance products that match the needs of the Chinese and international companies investing in Central Asia. The challenge is to match the demand for sophisticated financing and insurance solutions that suit the needs of Central Asian states with the SOEs’ distinctive business culture.
3.5. A case study of Chinese SOEs in Central Asia

According to a World Bank report on agriculture in Central Asia, the majority of agri-food exports from the region are still directed towards Russia. Nevertheless, in the near future China is predicted to be the main destination for Central Asian agricultural products. While hydrocarbon and mineral extraction remains the primary investment focus, the diversified climates of Central Asia are suitable for a vast array of horticulture, livestock and dairy products.

In fact, the local agribusiness sector has already witnessed the interest of several international companies, among them some Chinese public and private companies willing to invest in the region – providing capital, machinery and preferential access to the Chinese market. At the moment Kazakhstan is the leading agribusiness exporter to China, while the other Central Asian countries have very limited exports. As an example, in Mongolia the livestock sector is at the core of the country’s agricultural development policies, but several impediments to exporting remain.

Almost all countries in the region suffer from the same set of problems: production seasonality, outdated production technologies based on Soviet-era systems, the lack of a proper cold supply chain and cold storage facilities, substandard veterinary controls and small production volumes. In particular, China’s quarantine and custom regulations on labelling and phytosanitary requirements present a high entry barrier to Central Asian agri-products. As an example, following extensive due diligence and on-site inspections in Tajikistan, a leading industry investor from China has decided to expand its international portfolio of cotton fields, and to construct several processing plants paired with product quality control and inspection centres in the country.

One example of Sinosure involvement is a 2015 investment in Tajikistan’s agribusiness sector. Total project capital expenditure amounted to US$ 40 million, of which the investor contributed US$ 4.5 million, supplemented by leveraged share capital loans from a leading Chinese bank, which would be serviced via the project’s later-stage revenues. Sinosure risk analysis focused on two main concerns: expropriation and currency convertibility. Regarding the first concern, there were several prior experiences of government defaults on contracts with international investors, so investor or lender confidence in the government’s execution of investment promotion policies was limited. In terms of currency convertibility, despite the favourable and clear legal framework that permits foreign investors to convert and remit their investment earnings, Tajikistan has limited foreign currency reserves, standing current account deficits and a record of external debt default that may lead to unexpected convertibility issues.

Sinosure therefore underwrote the following insurance scheme:

- Equity tranche: US$ 4.5 million of investors’ paid-in share capital.
- Debt tranche: US$ 42 million (US$ 30 million on the share capital loans and US$ 12 million on interest payments).
- The tenor of the insurance policy was 10 years.

Sinosure’s coverage protected against up to 95 per cent of the losses incurred by expropriation, war and riot, and restrictions on currency convertibility events. The overall package was designed to limit investor risk exposure and boost investor confidence. Meanwhile, Sinosure coverage facilitated the investment financing by increasing lender confidence in the loan.

The above-mentioned example underlines how the Chinese footprint in Central Asia’s agribusiness and food processing is relatively small compared to investment in the mining and energy sectors. This investment pattern is changing, however, with new investment spearheaded by large state-owned companies such as China National Cereals, Oils and Foodstuffs Corporation (widely known as COFCO). Kazakhstan’s Eurasia Agroholding group of companies and China’s COFCO are developing three export-oriented tomato-paste processing plants in the West Kazakhstan, Kyzylorda and East Kazakhstan regions. The new JVs are part of a selected group of companies in the broader Kazakhstan-China industrial investment cooperation. One of the first positive outcomes is the planned employment of more than 1,000 people in each plant. Moreover, from 2017 COFCO accelerated its pace of building grain warehouses and logistics facilities in Kazakhstan.

The evolving investment scope of SOEs in Central Asia provides an important case study for the evolution of the BRI investment in the SREB and also in other areas covered by the initiative. The impact of Chinese SOEs in this sector has the potential to benefit local economies, especially when integrated with international companies, international financial institutions and stakeholders.
Chinese state-owned JVs in Central Asia, such as those in the agribusiness sector, need to balance a government-led approach with inherent bureaucratic inertia and the market’s need for fast response to change. The interaction between market forces and local stakeholders will strengthen much-needed oversight in areas such as food safety or even industrial competitiveness.

Nonetheless, the distinctive business culture that Chinese SOEs have developed within China can be a hindrance to the region’s sustainable development if not addressed appropriately. Much of the ability and confidence of Chinese SOEs to operate successfully within China relates to the fact that they do not respond to market forces alone, but are used to operating in a hybrid context shaped and organised to accommodate Beijing’s policies. However, the relationship between the Chinese government and the SOEs is not exclusively top-down. The operational behaviours of SOEs overseas can also be seen as bottom-up, aimed at influencing Beijing. In this respect, the latest round of SOE reforms is aimed at creating a more efficient SOE sector – but not necessarily a privatised one.

Chinese SOEs in agribusiness not only have access to the internal Chinese market, but have also started to compete globally, as is evident from Beijing’s trade surplus and accumulated foreign exchange reserves. The misallocation of capital to unprofitable and high-risk investments is a clear risk. This risk can not only harm Beijing’s sustainable development during the ‘new normal’ of a lower-growth economy and SOE reforms, but also plague Central Asian markets by importing market distortions and inefficiencies.

In these circumstances, a proper risk appraisal and resource allocation mechanism, worked through and discussed with an IFI able to provide co-financing, will help to increase the effectiveness of the investment as well as drawing in additional funding. Balancing political and market decisions in resource allocation is the first step towards long-term sustainable development and to a more fruitful Chinese economic expansion.

Compared to other sectors, agribusiness is often a low-technology, high-risk investment environment. The cost of bank lending is therefore often comparatively higher than for other sectors. Besides the abovementioned problems specific to this sector, agribusiness investments share the other challenges that plague the region, namely: undeveloped regional market and connections, internal trade barriers, government inefficiencies and widespread corruption. Chinese banks together with IFIs have the opportunity to develop a more efficient risk-appraisal system that can facilitate increased lending to SMEs alongside SOE lending. Despite initiatives to increase SME lending within China, Chinese banks – not only in agribusiness – prefer lending to SOEs. The Chinese state-led banks continue to assess SOE lending as lower-risk, as a result of their often-dominant market position, government support and access to significant assets that they can pledge as collateral.

In order to promote efficient companies – and not simply to protect state assets or corporate interests – it is necessary to provide low-interest rate bank loans coupled with a transparent and accountable review mechanism. Such cooperation can mitigate the risks associated with excessive politicisation of market decisions and promotes transparency over both local and imported corruption.

3.6. China’s perspective on security risk assessment and management

China’s expanding economic influence in Central and especially South Asia is also increasing the government’s involvement in regional security, which is gradually replacing China’s decades-old principle of non-interference. After all, the situation in Central Asia cannot be separated from China’s US$ 63 billion financing pledged to its flagship BRI project, CPEC. The security threat to Central Asia and China is intimately connected with Afghanistan and Pakistan’s fragile and multifaceted security environments.

The August 2016 attack on the Chinese Embassy in Bishkek by Turkestan Islamic Party (TIP) fighters demonstrated for the first time that Chinese diplomatic missions, and personnel in Central Asia working on the BRI, are potential targets for politically motivated attacks. In nearby Pakistan, terrorist and criminal violence has cost the lives of dozens of Chinese workers, including a suicide attack on a Chinese commuter bus; the killing in Karachi of the COSCO shipping line general manager for Pakistan; and the beheading of two Chinese citizens in the province of Quetta by ISIS affiliates.

Extremist threats in the region include the Islamic Movement of Uzbekistan (IMU), the TIP, and the increasing number of estranged younger Central Asians who joined jihadist groups in Afghanistan and Syria. Periods of economic slowdown and unequal economic growth have provided fertile ground for radicalisation and organised transnational crime. Government efforts in the border areas to control drug, weapon and people trafficking are hampered by low efficiency and endemic corruption.
The BRI encompasses China’s national and international interests: the government considers economic prosperity to be the cornerstone of stability, both domestically and in neighbouring countries. China’s interest in the Central Asian states is therefore linked with Beijing’s anxieties over Xinjiang inter-ethnic tensions between the Han and Uyghur populations. From the government’s strategic perspective, increasing the prosperity of neighbouring countries is the crucial factor in ensuring social and political stability. In the recent past Xinjiang’s tense ethnic balance between Uyghur and Han led to episodes of violence that had ripple effects across the region. Uyghur communities are present in all Central Asian countries, with differing degrees of social integration. Yet, while stabilisation is an objective of the BRI, the growing number of Chinese workers in Central Asia, coupled with varying degrees of Sinophobia, has occasionally led to friction with local populations.

China and the Central Asian states agree that militant groups are a major threat to national stability. One sign of China’s expanding counterterrorism effort is the suggestion that it might open a second Chinese military base in Afghanistan, in the bordering Wakhan corridor. The fight against the ‘three evils’ of separatism, extremism and terrorism is a fundamental internal and foreign policy concern shared by China and bordering countries. It is not by chance that the struggle against militant groups is at the core of regional security organisations the Shanghai Cooperation Organisation (SCO) and the Collective Security Treaty Organisation (CSTO).

A major concern relates to the return home of veteran fighters who have gained combat experience abroad. The radicalisation into violent Islamist groups and ideologies among disaffected young people from Central Asia and the Uyghur community is similar to the historical ties that the regional militant groups share with Afghan and Pakistani fighters in tribal areas. Most notably the TIP (previously known as the East Turkestan Islamic Movement, or ETIM) supported Al-Qa’ida actions in the region, while an increasing number of Uyghur militants found shelter in nearby Waziristan (Pakistan). Current analysis identifies a growing number of Central Asian militants who have joined other international jihadist groups affiliated with ISIS, as well as Jabhat Al-Nusra in Syria under the flag of Al-Qa’ida.

Box 4: Common impacts of terrorist attacks on business

- Property damage.
- Injuries to employees.
- Project delays.
- Loss of income.
- Disruption of supply chains.
- Lawsuits by victims and their relatives.
- Third-party lawsuits.
- Media exposure.
- Indirect loss of income.

The potential and actual impact of terrorist attacks along the BRI, including in Central Asia, is widely discussed at international governmental forums and in security circles. However, from an economic and financial standpoint, the process of risk mitigation and the application of ad hoc insurance policies are still in their infancy. Managing and mitigating this kind of risk is difficult due to the lack of available data and the absence of a mutually agreed and legally binding definition of terrorism. Yet the economic impacts of terrorist attacks include devastating and long-term negative effects on project investment, on its related supply chain and on overall economic growth.

Furthermore, unnecessary security measures and anti-terrorist expenditure can increase project costs without improving efficiency or effectiveness. For example, in Central Asian areas with minimal risk of a terrorist attack, it would be more effective to invest in CSR policies to promote better understanding of the local culture and integration with Chinese contracting companies, rather than increasing the number of private security officers.
Nevertheless, several areas in Central Asia are still associated with perceived risks of possible militant attacks. This perception affects investor confidence even when not based on sound evidence. One of the main challenges in providing an accurate measure of the risks of terrorism and violent crimes that could cause loss of life and property damage is the lack of historical reports. Therefore, risk insurance can only be based on the use of proxy data, in the absence of a consistent database that monitors the occurrence and frequency of any attacks, the intensity of the damages, and the geographical scope.

As noted, the overall terrorism risk ranking of Central Asian countries is low. Nevertheless, the first and only terrorist attack on a Chinese diplomatic institution abroad took place in the Kyrgyz Republic, with the bombing of the Chinese embassy in Bishkek. Another problem for insurance pricing is how to assess the severity of attacks. Damage resulting from accidents ranges in severity and intensity, but a terrorist attack will often be seeking to achieve the maximum impact, with the effect of any harm to people and property multiplied through media exposure.

The evaluation of the specific severity and intensity related to terrorist attacks results in insurance premiums at the upper scale of the price range. In this context, some specific areas such as the Fergana valley, perceived as a target of opportunity by militant groups and prone to border clashes, present an accumulation of risk that could discourage any kind of commercial insurance.

Criminal violence and the possibility of kidnapping for ransom are also realities in the border areas of several Central Asian states. Afghanistan’s porous border with neighbouring Central Asian countries makes for a major highway for drug traffic.

Risk assessment is required to start a project but also it is imperative to monitor the project implementation, as local problems could ignite unforeseen hostilities. The social and environmental impact of infrastructure projects in local communities could alter the internal dynamics of power and wealth, exacerbating local tensions or even generating new ones.

3.7. China’s approach to Central Asia risk guarantee: the role of Sinosure

Today, multinational and national financial institutions that seek to price risk along the BRI face a common set of problems, and tend to overestimate some kinds of risks while undervaluing others. Compared to their international peers, Chinese state-owned policy and commercial banks – which are supposed to have a greater risk appetite – also encounter difficulties while underwriting loans in high-risk investment regions.

The response from the Chinese banks is to use the insurance cover provided by the China Export and Credit Insurance Corporation (Sinosure). Sinosure’s engagement in Central Asia predates the BRI. Since 2001, Sinosure underwriting has included massive energy projects such the Central Asian Gas Pipeline and mining and steel mill investments in Kazakhstan, Tajikistan and Uzbekistan. In the past two decades, and especially after 2013, Chinese credit insurers have been expanding their export credit business rapidly – with Sinosure among them as the lead provider. Besides being focused on medium or long-term export credit insurance, Sinosure’s role as guarantor for Chinese bank lending is of particular importance in funding Central Asian FDI. Sinosure’s guarantee to the SOEs will also benefit other stakeholders involved in regional projects. However, while Sinosure’s leadership role is clear, it is difficult to get precise data on the scale of this support.

Sinosure’s usual approach is to insure half of 80-85 per cent of the loan value. Local Sinosure branches across China conduct the initial risk assessment and help to structure the financing vehicle, while the Beijing head office grants final approval.

Sinosure’s loans are typically issued through a bank, which will then grant a loan on the basis of Sinosure’s guarantee. The Sinosure guarantee comes into force in case of the borrower defaulting, thereby covering the bank’s claims. This means that including Sinosure in any loan syndication process will guarantee the involvement of the Chinese government in the agreement.

On the whole, Central Asian countries are not particularly sensitive to the implicit role of the Chinese government in Chinese SOEs’ investment, compared with some other BRI-related countries. They see the engagement of SOEs as a chance to address the fragilities inherited from the Soviet-era planned economy. They then seek to balance China’s engagement with a diversified approach to foreign investment and international relations, including with Russia and the EU. While the SOEs are welcome, however, the impact of Chinese workers’ employment on the local communities does remain a concern as mentioned earlier.
One recent example of Sinosure spearheading Chinese investment in Central Asia in partnership with international lenders is the prospective insurance cover for financing in Uzbekistan worth US$ 400 million. In May 2018, the National Bank for Foreign Economic Activity of the Republic of Uzbekistan (NBU) and Sinosure signed a framework agreement on cooperation to insure the financing of the supply of Chinese high-tech materials for commodities-processing projects led by Chinese companies.

Regarding the risk related to terrorism, the primary source countries of Sinosure’s outstanding portfolio in Central Asia (such as Kazakhstan and Uzbekistan) have limited their exposure to such risks, while the projects themselves are predominantly based in relatively safe districts and regions within each country. As such, while Sinosure will check the projects’ compliance with anti-terrorism laws, the projects themselves are not likely to be directly affected by direct terrorist attacks.

Sinosure’s approach to underwriting is based on China’s concept of a “market economy with Chinese characteristics”. It also has a role to play in promoting the internationalisation of the yuan in Central Asia and more broadly across Eurasia. Despite this risk management approach, there remains a need to improve the capacity of China’s banking system to price, manage and mitigate risk in its overseas lending activities. In assessing the risk of the Belt and Road in Central Asia, it is necessary to consider risks to both the borrower and the lender. Uncontrolled, aggressive risk appetite and risk pricing could lead to non-economic lending and investment decisions. Non-performing investments could negatively impact the recipients of Chinese FDI, and also destabilise current SOE reforms and modernisation.

Recently, the growing demand for Sinosure support along the BRI has increased pressure on the organisation to deliver detailed, prompt and timely responses to many different project enquiries. Sinosure has a significant need to both increase its capacity and further develop its capabilities in providing its services. This represents a good opportunity for IFIs to participate in providing not only loans, but also additional project finance expertise and talented personnel.

3.8. The evolving role of the Shanghai Cooperation Organisation

China has generally enjoyed good relations with Central Asian countries since their independence from the Soviet Union in 1991 (Mongolia became a non-aligned state in 1989). In addition, China has cooperated to demilitarise the border regions and develop confidence-building measures, starting in 1996 with the informal group of the “Shanghai Five”: China, Russia, Kazakhstan, Kyrgyz Republic and Tajikistan. The group resolved disputed border issues; negotiations were completed in a matter of years. Later in 2001, the group established the Shanghai Cooperation Organisation (SCO), which began its activities in 2003.

The SCO now also includes Uzbekistan, India and Pakistan as members; Afghanistan, Belarus, Iran, Mongolia, as observer states; and Armenia, Azerbaijan, Cambodia, Nepal, Sri Lanka and Turkey as “dialogue partners”. Among the Central Asian countries only Turkmenistan has not joined the organisation. All the Central Asian countries share China and Russia’s anxieties about the spread of religious extremism. As a result, the core stated aim of the SCO is to maintain peace, stability and secularism in the region.

Over the past 15 years the scope and structure of the SCO has broadened, from a unit focused primarily on border security and counterterrorism, into a multilateral organisation involved in economic and cultural cooperation.

From an economic standpoint, the SCO Interbank Consortium (IBC) was established with the Agreement on Interbank Cooperation (Consortium) within the SCO on 26 October 2005. The SCO IBC is a mechanism for financing and providing banking services to investment projects, supported by the governments of the SCO member states in priority areas of cooperation. The Consortium’s mid-term development strategy for 2011-16 was adopted in St Petersburg in 2011 to update priorities of joint activities in the context of current economic development goals of the SCO member states; widen the scope of activities by involving financial institutions of observer states and dialogue partners; and monitor implementation of joint regional investment projects. The SCO IBC medium-term (2017-22) development strategy includes closer cooperation with China’s US$ 40 billion Silk Road Fund.

In support of the SCO’s security and economic integration agenda, the consortium also counts on the more informal Business Council of the Shanghai Cooperation Organisation. The Business Council is a non-government entity that fosters the participation of SCO members’ companies and representation of the business communities of the SCO member states during annual meetings. The Business Council’s mission is to expand economic cooperation via direct relations between business and financial communities. China Development Bank, currently chair of the IBC, has issued over US$ 100 billion in loans to SCO member states in the past 14 years.
In the years ahead, it will be important to strengthen cooperation across the various local currencies, and to innovate – not only in financial tools, but also by integrating the SCO’s experience in dealing with non-traditional risks into the financial sector. In this respect the consortium can promote the role of economic investment as a stabilisation factor. The SCO’s internal knowledge, organisation and capabilities in understanding, preventing and mitigating security threats can provide the necessary and urgently needed knowledge to the insurance sector. The SCO IBC can become an increasingly important financial integration platform in Eurasia, promoting the development of new financial instruments for the implementation of major transnational investment projects.
4. Approaches to mitigating risk

4.1. Potential routes to improving risk mitigation

As set out above, foreign investors face a common set of challenges across the countries of Central Asia. While the ease of doing business varies, a common challenge is the difficulty of trading across borders, in part because of poor regional integration.

Improvements to risk mitigation can be made at both the project level and the macro level. For larger infrastructure and resources projects in particular, some of the broader country-related challenges can be partitioned off through the design of the project. Sustained broader development, however, requires tackling the macro environment. Initiatives at the regional level are particularly valuable, given both the small scale of a number of these economies, and the potential for peer comparison and competition that this approach offers.

At the project level, risk mitigation can be improved through a detailed, specific and holistic assessment of all risks from the outset, combined with a well-defined and ongoing risk monitoring process. This will naturally include: a financial assessment of revenues, investments and operating costs; a full assessment of the project context; risks to the project relating to the business environment of the country involved; the project’s community and environmental impact; and security risks.

This is hard to do in an objective and sustained way when both the number of stakeholders involved and the level of transparency are low. Wang Yi, China’s Foreign Minister, has called the Belt and Road Initiative a “sunshine initiative” where everything will operate transparently and be open to all. Central Asia provides an opportunity to put this into practice. This does not mean that all information has to be fully publicly available. It can, for example, mean close cooperation with other stakeholders in multilateral and commercial organisations, as well as with the relevant country government. Increasing the number of stakeholders, and sharing and agreeing on key information, provides the basis for more objective risk assessment and mitigation.

At the macro level, measures that improve the business environment will both enhance economic growth and reduce the riskiness of individual investments. Priorities include:

- strengthening the court system, the capability and independence of the judiciary (for example, through training, recruitment and greater transparency)
- improving oversight and regulation of the banking sector, together with continued improvement in risk management capabilities and the data that support good risk management (for example, credit bureaux, a consistent approach to company credit rating, and informational integrity measures to reduce fraud) and
- streamlining customs processes, tariff schedules, and import and export approvals so as to reduce the cost and delays which characterise regional trade.

Regionally, it can be valuable to identify areas that could benefit from regional cooperation, and where each country can also see the value of cooperation there. Given the differing stages of development and transition to market economies in the region, it is advisable to be pragmatic about which countries should get involved in which aspect of cooperation: this can vary from case to case. In particular, regional cooperation can be of value in:

- customs harmonisation and the streamlining of regional trade, or, at a minimum, addressing certain key bilateral country pairings to jump-start the process
- development of a regional financial network and centre (Kazakhstan is best-placed through its AIFC initiative and its sheer size to lead on the creation of regional capital markets)
- credit rating and databases (these can benefit from a consistent approach across the region, building on experience in the different countries) and
- addressing Islamist-related and returning jihadist tensions, through both common security and border measures, and consistent approaches to re-engage jihadists economically and socially
4.2. The role of public-private partnerships

The use of public-private-partnerships as a risk-sharing mechanism has been growing in Central Asia. The application of an appropriate regulatory system in Central Asia, aimed at improving transparency and investor protection in the long-term financing of projects, will enhance funding availability. Importantly, it will also bring much-needed scrutiny and market efficiency.

China too has been actively promoting the role of PPPs since 2014, so as to enhance the financing options available to manage infrastructure project risks. However, in mainland China, some local governments have abused the PPP concept by using PPP vehicles to channel funds into inefficient projects. Although they first started in the 1980s, PPPs have only gained traction in the past few years, due to the support from the central government in Beijing, improved investor protection measures, a more transparent regulatory framework, and the growth in investment value.

Since the beginning of 2017, China has been actively promoting the use of PPP contracts in countries involved in BRI infrastructure projects. On 1 November 2017, the China Public Private Partnerships Centre (CPPPC) and the World Bank signed a Memorandum of Understanding with the aim of promoting the professional competence of PPP practitioners.

PPP projects along the BRI will involve government authorities, financial institutions, project investors and EPC contractors. Cooperation between the public and the private sector will provide specific advantages, both in financial burden-sharing, and also in design, construction, operation, management and maintenance.

An example of the role of IFIs is given by the 2015 Kurty-Buribaytal road modernisation which involves the Kazakhstan Ministry of Finance and the CAREC (Central Asia Regional Economic Cooperation) framework. Kazakhstan has already developed a specific legal framework to foster the adoption of the PPP. The new model has been developed with the participation of the EBRD and the World Bank and it aimed at expanding the privatisation programme of state infrastructure assets and supporting the growth and risk sharing of private sector enterprises.

Implementation of the PPP model will provide positive externalities for the BRI recipient countries and support their infrastructure funding. However, a lack of transparency in the application of the PPP model could negatively affect the debt structure of Central Asian countries, and perpetuate the lack of transparency on the economic attractiveness of BRI projects.
5. Conclusion and implications

Managing risk in Central Asia – along the Belt and Road Initiative and elsewhere – requires blending financial risk management with non-traditional risk analysis and mitigation. Any risk management there takes place in the context of significant challenges in doing business, high levels of corruption and variable political security risks across each country. In each country, there is ongoing economic and social reform as well as varying efforts at intra-regional integration.

China’s significant increased engagement in the region through the BRI increases both the potential for benefit and the potential for risk. Both will only increase as investments spread further beyond an SOE-led, resources and transport focus to a more diverse mix of state-owned and private businesses, across many sectors. While each country has a challenging business environment, the actions of some Chinese investors have created further risks through disregard for environmental issues, and insufficient local job creation and engagement with local communities.

China’s SOEs are getting better at addressing the risks in Central Asia. There are, however, still substantial gaps – including their willingness to pay up-front for insurance and other measures that reduce risks in the medium term; their ability to take a long-term view on engaging with local communities to build community support for investment; and their excess reliance on government-to-government support as a backstop, rather than preventing problems from the start.

Financing from state-owned policy and commercial banks, together with credit insurance from Sinosure, has improved risk assessment and mitigation. However, it still falls short of what could be achieved by partnering with Western banks and insurers and drawing on their expertise. Furthermore, work is needed to improve the database of information against which risks can be assessed, both in terms of their frequency and severity. And ultimately, this insurance and risk transfer approach has a focus on risk management, rather than risk mitigation and reduction. It is also clear that both the Chinese state banks and Sinosure will place an even greater focus on risk assessment in future, consistent with President Xi’s call for “quality” projects in the Belt and Road and to enhance the protection of Chinese workers abroad. The recent public statement by Sinosure that they incurred losses of US$ 1 billion in the Ethiopian railway project demonstrates the attention being paid to these concerns.

The scale and the pace of SOE investments in the region has led to direct intervention by Beijing regulators to implement a top-down approach and gradually introduce the required standards. Developing commonly agreed standards will enable performance appraisal, as well as the introduction of tools that will promote efficiency, effectiveness and better economic performance. While China is already working on this pattern at national and provincial levels, the adoption of performance-based standards and risk appraisal tools along the BRI is still lagging behind. These measures are a consistent and important part of China’s overall SOE reform agenda: this agenda focuses on the improved efficiency and effectiveness – both in China and increasingly overseas – of the state-owned sector, operating alongside a strong and vibrant private sector. Measures that make SOEs more resilient, more capable and more able to manage risks fit firmly within the reform agenda of the Chinese government – which places emphasis on experimentation and adaptation of different approaches to the local context.

China has a longstanding policy of non-interference, but this does not mean that China will not support processes for increasing standards. First, many countries face challenges in the thorough implementation of their own local standards: improving implementation would in itself lead to better outcomes. Second, China would in general be happy to engage in building consensus with other countries on ways to improve standards that benefit both their own Chinese SOEs and the economies and populations where they operate. Third, Chinese technical dominance in many of the projects in Central Asia comes with the use of Chinese technical standards. What matters therefore is a clear rationale of benefits for all, rather than an attempt to bind in a uniform set of standards in all circumstances without consideration to context.

More broadly, China has embarked domestically on strengthening its own risk management capabilities, while still recognising that it is an ongoing effort. China seems a complementary and willing partner in addressing the same challenges in Central Asia: it combines its position as the leading investor and trade partner with practical experience of what works and what does not. Moreover, cooperation with international financial institutions can provide the basis for a common approach to many issues in Central Asia.
More specifically, efforts at risk mitigation can be strengthened through five areas of action involving China and the international financial institutions:

1) Work together to identify priority standards on governance, economic performance, environmental impact and community engagement that will enhance project risk management (financial and non-financial) and help Chinese SOEs develop their capabilities to operate overseas, in Central Asia and elsewhere. This will complement and strengthen China’s own initiatives to improve the quality of BRI investments, to address risks and to reform and internationalise its SOE sector. Such cooperation can be a helpful mechanism for engaging all stakeholders in consensus-building with individual country governments. It will also reduce pressures on Beijing to become involved in any particular project situation at a government-to-government level, placing the onus on individual SOEs to manage their own challenges and take responsibility for their investment choices.

2) Identify priorities for improved data standards, data collection and analysis to support improved credit, market and operational risk management and financial and business decision-making across the region. This could, for example, take the form of a regional credit bureau designed and financed jointly by interested national governments, key foreign investor countries and appropriate IFIs. Improved quantitative tracking of security risks would also contribute to more realistic assessments of actual risk (versus perceptions of higher risk) and improve the ability to price and insure these risks. Such initiatives would also help to upgrade the financial sectors in each country; reduce financial sector risk; improve regional financial integration; and contribute to enhanced capabilities in the Chinese financial sector.

3) Continue to support the economic and social transitions of individual Central Asian countries, paying due regard to national contexts, while encouraging continued intra-regional integration. Place a particular focus on private sector development, rule of law, corruption and ease of trading across borders within the region. This focus echoes clearly President Xi’s own agenda for China: a commitment to complementary roles for state-owned enterprises and privately owned enterprises; strengthening of the rule of law; a fight against corruption in all places, including when Chinese companies operate overseas; and a commitment to increased opening of the Chinese economy and the maintenance of the global trading system at a time of protectionist pressures.

4) Identify priority projects to spread use of the PPP model across Central Asia – both to draw in additional finance, but critically also to bring in greater expertise, transparency and improved governance of key projects in uncertain, non-transparent business environments. Identify key project metrics that can support increased comparability and accountability across countries. China’s own efforts to reform the PPP model within China provide a worthwhile base for engagement, alongside the cross-regional experience of the EBRD and other IFIs. China’s critical role in the region as an investor makes it a valuable partner in engaging Central Asian governments on what approach to take. Its participation in such projects in Central Asia will also provide a further means for Chinese companies to gain experience in this area that can in turn be applied in China to strengthen the effectiveness of PPPs at home, as well as in other countries where Chinese companies operate.

5) Recognise the evolving role of the SCO and the CSTO in addressing key sources of risk across the region, including but not limited to political and security risk. Determine how best to engage and complement measures that support intra-regional integration, improved trade and business, and regional cooperation on financing.

6) Focus the bulk of security-related efforts on initiatives to address socio-economic inequalities and improve community engagement, in light of currently low levels of terrorism and other security risks.

Ultimately, the sustainable development and security outlook of each Central Asian state is deeply intertwined with its neighbours’ stability and economic development. As well as contributing to the development of each country, China’s Belt and Road Initiative has the potential to speed up broader regional integration with Central and South Asia. This will, however, be most effective when partnering with others, both at a state level and with multilateral institutions, to understand and pre-empt risks. Without this, the complexity and diversity of the endeavour may prove too much. China is well aware of both the
opportunities and the challenges, and of the need to engage with many different stakeholders who can contribute different experiences and perspectives. In fact, the policy measures to address the challenges across Central Asia are consistent and highly complementary with China’s ongoing reform efforts. Partnering will allow China to realise its shared agenda of objectives in a sustainable way.
Annex 1. Country profiles

Kazakhstan

Overview
Kazakhstan is the most developed and geographically largest of the Central Asian economies, with extensive hydrocarbon reserves. It has also been the most successful at attracting foreign direct investment – especially into resource extraction – and has benefited from investment in transport infrastructure.

Kazakhstan is the easiest place to do business in the region. It ranks 36th out of 190 countries in the World Bank’s 2018 Ease of Doing Business index. This high ranking, however, masks large divergences between areas that work well and those that remain major challenges: cross-border trade remains the toughest area, with Kazakhstan ranking 123rd out of 190 countries. Corruption remains a significant challenge for foreign and domestic businesses. Kazakhstan ranks at 122 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017.

The government has made strong efforts to attract foreign investment and continues to do so, while at the same time pursuing policies to develop local enterprises.

Sovereign risk: Macroeconomic, political and security risk
Kazakhstan’s economy has had to go through a period of adjustment to lower energy prices. The outlook continues to present some risk, but overall the government has acted strongly to make necessary adjustments. Political stability remained high, following the succession of President Nazarbayev, who made large efforts to cement Kazakhstan’s position and identity, balancing relations with China, Russia and other neighbours. Questions remain, however, about what happens after the recently appointed President Tokayev’s mandate expires in April 2020. The threat to stability during a political transition in Kazakhstan is mostly related to the presence of a large ethnic Russian minority in the north-western part of the country. The Russian population in Kazakhstan shrank significantly in the past two decades. But compared to other Central Asian countries Russian normative and linguistic soft power is still vibrant, as most people in Kazakhstan are fluent in Russian.

Moody’s issued a sovereign rating of Baa3 in 2017 for Kazakhstan and also rates a number of other entities in the country. The rating outlook was raised from negative to stable in July 2017, as Moody’s assessed that the economy had adjusted well to the impact of lower oil prices. The Baa3 rating rests on the relatively high GDP levels, low level of public debt and significant fiscal reserves. Against this, Moody’s notes low institutional strength and a high proportion of foreign currency government debt with the associated foreign exchange exposure. While Moody’s is positive on the government’s efforts to restructure the banking sector, the sector remains a risk.

Following this, in November 2017, Dagong upgraded its own outlook to stable, while maintaining a sovereign rating of BBB for local currency debt and BBB- for foreign currency debt. Dagong cited many of the same reasons as Moody’s, but also gave strong prominence to the political stability of the country that allows policy continuity, strong progress in de-dollarisation of the economy and the value of its resources reserves for long-term development. Dagong did, however, note some risks of terrorism and geopolitics that could weaken stability.

IMF visits in 2017 and 2018 identified the need to improve financial sector regulation and supervision; the significant fiscal risks resulting from public infrastructure investments; and the need for overall supervision of state-owned enterprise related risks.

Business environment risk: Project implementation and operational risk
Kazakhstan has the highest ranking within Central Asia on the World Bank’s 2018 Ease of Doing Business index, ranking 36th out of 190. Particular strengths are: protecting minority investors (1st); enforcing contracts (6th); registering property (17th); and starting a business (40th). The largest challenges are cross-border trade (123rd), reflecting the regional context and very slow customs clearance, and access to credit (77th) and availability of electricity (70th). The country has achieved this ranking through specific
Risk assessment and mitigation in Central Asia: implications for foreign direct investment and the Belt and Road Initiative

The government is committed to further development. Following the fall in the oil price in 2014, it embarked on a major programme of fiscal adjustment, state-owned enterprise restructuring and privatisation, and improvement in the business environment. One initiative, the “100 Concrete Steps”, aims to improve the rule of law, the civil service, governance and the business climate. The Kazakhstan 2025 strategic plan focuses on high-quality growth and gains in competitiveness and productivity, with the aim of becoming one of the world’s top 30 developed countries by 2050.

As things stand, however, the government remains somewhat interventionist in its economy. State-owned enterprises still play a substantial role; greater efforts are needed to foster private sector development. The court system and rule of law is rather weak, though this too is the focus of improvement efforts by the government.

Corruption levels are high: Kazakhstan ranks at 122 out of 180 countries in the Transparency International’s Corruption Perceptions Index 2017. While legislation to combat corruption was passed in 2016, enforcement is highly selective and is generally ineffective in combating the corruption of public officials. Regional officials often interpret regulations in ways that differ from central government. This acts as a significant barrier to many foreign investors.

Financial sector: Credit, interest rate and market risk

Financing in Kazakhstan is primarily through the banking sector, although strong efforts to develop capital markets are underway, including the development of the Astana International Financial Centre. Kazakhstan has by far the most developed capital markets in Central Asia.

The banking sector suffered a crisis in 2009, which caused funding to dry up and problems for businesses operating in the country. Government intervention and restructuring has made progress to resolve these issues and drive consolidation in the sector. Banks are steadily building their credit risk management capabilities, though further progress is needed. Dollarisation is significant and is now being reduced. Further progress is needed on banking supervision and resolution of problem loans.

Sustainability: Environmental, social and climate risk

Kazakhstan faces significant environmental and climate challenges, including radiation from nuclear testing sites, the shrinking of the Aral Sea and desertification from excessive irrigation in order to promote cotton production in the Soviet era. Air pollution is also rising in urban areas.

The limited nature of civil society and NGO activities limits monitoring and management of potential issues.

Specific considerations for foreign investors

Kazakhstan has been very successful at attracting foreign investors, especially into natural resources, which accounts for 70 per cent of FDI. In 2017, inward FDI was US$ 4.6 billion, with a total FDI stock of US$ 147 billion. FDI into manufacturing is steadily increasing as the government seeks to diversify away from natural resources. Foreign investment flows from a wide range of countries including the USA, China, Russia, the Netherlands, the UK, France and Japan. China’s investment is increasing as part of the Belt and Road Initiative.

In priority areas, the government offers preferential treatment for those who invest in “priority investment projects”. KazakhInvest has been recently established to coordinate and facilitate the attraction of foreign investors. Kazakhstan is taking steps to make contract terms more transparent, and to offer more attractive tax treatment to encourage oil and gas exploration.

Developing high-level central government relations, and aligning investments with the development of the Kazakh economy, are critical in navigating Kazakhstan’s business environment successfully. Effective top-down enforcement can then offset the challenges of corruption, variable contract enforcement and the pervasive role of state institutions in the economy.

Foreign exchange and capital controls risk for foreign investors

In August 2015, the government floated the tenge, leading to an immediate devaluation of 40 per cent, following a fixed devaluation of 19 per cent in 2014. This caused an initial shock, but now provides
flexibility in adjustment. The tenge remains fully convertible, while legally there is only current account convertibility; recently, volatility has increased again. From 2019 onwards, all domestic transactions must take place using the tenge, as part of the government’s de-dollarisation efforts.

Security risk

According to the Global Terrorism Index 2017 from the Institute for Economics and Peace, Kazakhstan Ranks 67th, with an Index value of 2.95 and a threat level of “low to moderate”.

The threat from terrorism in Kazakhstan is remote, but still present. The lack of a historically structured Islamic faith has in the past decade left room for the spread of more radical forms of Islam from Saudi Arabia and Pakistan. Some hundred young Kazakhs left their homes to wage jihad in Iraq, and later in Syria, under the flag of the “Black Caliphate”. However, the lack of a direct border with Afghanistan shields the country from direct terrorist threats. But the negative effects of Afghanistan are still felt as a result of the heroin route that crosses Kazakhstan on its way to Russia and the countries of Eastern Europe.
Kyrgyz Republic

Overview

The Kyrgyz economy is small, with limited natural resources besides gold, and highly dependent on remittances from overseas workers. The political situation is relatively stable within the context of a democracy with an active opposition and multiple successful transitions of power.

The Kyrgyz Republic ranks above many of its neighbours in terms of doing business. It ranks 77th out of 190 countries in the World Bank’s 2018 Ease of Doing Business index. Particular challenges are bureaucratic and ambiguous processes and access to energy and credit. Corruption remains a major challenge for foreign and domestic businesses. The country ranks at 135 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017.

While the government is keen to attract foreign investment, investors still find it a challenging environment, and investment has fallen in the wake of the largest foreign investor’s (Centerra Gold) dispute with several governments since 2015. Corruption, the variable implementation of relevant laws and the lack of an independent judiciary all play a role.

Sovereign risk: Macroeconomic, political and security risk

Moody’s has maintained a rating of “B2, stable outlook” for the Kyrgyz Republic since 2015. This assessment is based on the combination of relatively high debt levels, steady progress in the quality of institutions and a robust economy.

In terms of political risk, after a period of political upheaval the Kyrgyz Republic has seen greater stability in recent years in spite of the frequent changes of ministers and government. Since the first democratic handover of power in 2011, there have been a number of transitions, which have occurred without instability to foreign investment interests. The political opposition is free to protest, and does so. Protestors sometimes demonstrate against resources companies at their mining installations. Interethnic and Islamist-related tensions persist, and internal security challenges remain important.

Business environment risk: Project implementation and operational risk

The Kyrgyz Republic lies in the middle of the pack in terms of doing business, with a ranking of 77th out of 190 countries in the World Bank’s 2018 Ease of Doing Business index.

The business environment is improving. Reform has led to areas of relative strength, which are: registering property (8th); access to credit and starting a business (both 29th); and dealing with construction permits (31st). Important priorities for further reform remain: availability of electricity (ranked 164th); paying taxes (151st); enforcing contracts (139th); and resolving insolvency (119th). Protecting minority investors and trading across borders lie between 51st and 84th respectively and are above regional levels.

Corruption levels are significant – although at a somewhat lower level than in some neighbouring countries – and affect business transactions. The Kyrgyz Republic ranks at 135 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017. Public procurement remains prone to corruption. While legislation exists to combat corruption, enforcement is highly selective and is generally ineffective in combating the corruption of public officials. The unregulated, grey economy is estimated at 60 per cent of economic activity.

Financial sector: Credit, interest rate and market risk

Financing is primarily through the banking sector and local capital markets remain underdeveloped, with limited short-term government debt issues and two small stock exchanges.

Banking credit is allocated mainly on a market basis by a mixture of state-owned, local private and foreign banks.

Sustainability: Environmental, social and climate risk

The important role played by mining in the Kyrgyz economy has a significant environmental impact. Kumtor Gold, the main gold mining company, has received criticism and fines for violating environmental regulations. Kumtor’s foreign investor, Centerra Gold, is in dispute with the government over environmental
claims, although there is also a significant political aspect to this dispute. The Kyrgyz Republic is a member of the Extractive Industries Transparency Initiative, but is behind on its publication of reports. Foreign companies need to play an important role in raising and enforcing standards.

In addition, there are challenges of soil salinisation and desertification from previous agricultural policies and practices.

Specific considerations for foreign investors

The Kyrgyz government is keen to attract increased foreign investment into new and existing industries. In the past few years, foreign direct investment has remained very low: FDI inflows in 2017 were US$ 94 million, down from US$ 1.1 billion in 2015. The dependence of FDI on the Kumtor gold mining operation, which accounts for 10 per cent of Kyrgyz GDP, accounts for the decline. The total FDI stock was US$ 5.5 billion. The main investing countries are Canada (through the Centerra investment in Kumtor), China, the UK, Russia and Kazakhstan. FDI has flowed predominantly into the mining sectors and also finance and petroleum-related products. Non-mining FDI remains very low.

Since 2015, a dispute between the Canadian company, Centerra Gold, and the Kyrgyz government over control and profit payments from the Kumtor mine has weakened the investment climate. In August 2018, both sides agreed to extend again the deadline for implementing a resolution which had been reached in 2017. The issues involved of contract enforcement, disputes over environmental impact and payments, and allegations of corruption are emblematic of the challenges for foreign investors.

More generally, in terms of corruption, foreign businesses may find themselves the subject of frequent tax audits, while individuals may find their special foreigner car licence plates targeted by the police for stops. The Kyrgyz Prime Minister resigned in April 2016 following allegations of corruption in a US$ 100 million Chinese-financed highway tender.

The Investment and Trade Promotion Agency seeks to attract foreign investment. However, the implementation of applicable laws and regulations remains patchy. There are no legal limits on foreign control and ownership. But, in practice, any significant investment can be politically sensitive and subject to the need for specific conditions.

The FDI situation is starting to change, with China’s increasing interest and involvement. As of 2017, China had signed over 10 investment agreements worth US$ 1.8 billion.

Foreign exchange and capital controls risk for foreign investors

Foreign exchange is widely available. The Kyrgyz som is freely convertible and has been stable compared with other currencies in the region. In 2017, volatility increased as concerns over the fiscal and external balance situation grew. Very few issues are reported on conversion of foreign exchange.

Security risk

According to the Global Terrorism Index 2017, the Kyrgyz Republic ranks 79th, with an Index value of 1.989, and a threat level of “low”.

The Kyrgyz Republic is, together with Tajikistan, relatively conflict-prone within Central Asia. The risks include all those that afflict Central Asia: unresolved border disputes, land or water conflicts, religious extremism, separatism, arms and drug smuggling, and human trafficking. The economic problems of poverty and unemployment facilitate extremist recruitment and separatist tendencies. In the Tajik case, the Russian military base provides reassurance against terrorism and increased border controls against narcotic smuggling. Since 2018 the base has been upgraded in order to prevent possible penetration of militants from northern provinces of Afghanistan into territories of Central Asia. The base, not far from the capital, Dushanbe, is Russia’s largest non-naval military facility outside the country.
Mongolia

Overview

Mongolia covers an area twice the size of France, positioned between Russia and China, with extensive natural resources and a population of only three million. It is quite advanced in its transition to a market economy.

For these reasons, the country is structurally attractive to foreign investment. Mongolia ranks 62nd out of 190 countries in the World Bank’s 2018 Ease of Doing Business index. This high ranking, however, masks large divergences between areas that work well and those that retain major challenges: corruption remains a significant issue for foreign and domestic businesses. Mongolia ranks at 103 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017.

Since 2015, the government has made renewed efforts to attract foreign investment, and to diversify the sources of these investments to reduce dependence on China. More than 90 per cent of Mongolian exports are shipped to or through China; Russia provides 90 per cent of Mongolia’s refined petroleum products and 20 per cent of its electricity. In 2017, Mongolia agreed a programme of IMF support to prevent default on government debt and address structural reform.

Sovereign risk: Macroeconomic, political and security risk

The major role that resources exploitation plays in the economy means that activity, confidence and growth fluctuates with the commodity cycle. Between 2006 and 2016, GDP grew 233 per cent, yet growth fell from 17 per cent in 2011 to 1 per cent in 2016, before rebounding to 5 per cent in 2017. The government has significant external debt and faced a critical need to secure refinancing in 2017. While China has previously also provided liquidity directly, the government sought IMF support for a multi-donor refinancing arrangement of US$ 5.5 billion and is engaged in a further reform programme. This includes full consolidation of the government balance sheet, taking in the liabilities of the Development Bank of Mongolia.

In the wake of the agreement on IMF support to refinance debt, Moody’s upgraded Mongolia to “B3, stable outlook”. This also reflected the narrowing fiscal deficit.

However, Dagong downgraded Mongolia from B+ to B in November 2017, reflecting continued concerns about the government debt position.

Mongolia is a vibrant democracy with many different parties, factions within individual parties, and individual politicians with their own political, business and media interests. This results in volatile swings in sentiment between nationalism and an openness to foreign investment in resources development. Political violence and security issues are, however, rare. Nationalist sentiment expresses itself most strongly in opposition to Chinese and Western business investments.

Business environment risk: Project implementation and operational risk

Mongolia ranks 62nd out of the 190 on the World Bank’s 2018 Ease of Doing Business index. Despite its relatively strong performance compared with other Central Asian countries, Mongolia remains a challenging and volatile business environment. Economic growth is highly variable and linked to global commodity prices and investor sentiment.

Infrastructure remains a significant barrier in terms of access to energy supplies and in logistics and connectivity, especially to Russia. Mongolia ranks 139th on availability of electricity and 110th on trading across borders. Other challenges are enforcing contracts (88th) and resolving insolvency (93rd). Mongolia performs well on access to credit (22nd); registering property (50th); protecting minority investors (33rd); and dealing with construction permits (23rd).

Corruption remains a persistent challenge in doing business: Mongolia ranks at 103 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017. The 2006 Anti-Corruption Law is poorly enforced. In general there is a relatively weak civil service bureaucracy and a lack of transparency and data. Contract enforcement is a problem: the judiciary does not consistently act as an independent entity in the way stipulated in the constitution.
Financial sector: Credit, interest rate and market risk
Financing in Mongolia is primarily through the banking sector although there is a local stock exchange, which the government plans to develop further. Access to credit is not a significant issue within the domestic economy.

The banking sector is a mix of state-owned and private sector banks, owned by Mongolian and foreign investors. There is steady progress in government-encouraged consolidation and banks are steadily building their credit risk management capabilities, though further progress is needed. Enforcement of existing bank regulation remains a challenge. The current IMF programme continues to emphasise strengthening of the sector and greater independence for the central bank.

Sustainability: Environmental, social and climate risk
Mongolia’s environment is for the most part unspoiled, but faces problems from mining legacies. Ulaanbaatar has some of the worst air pollution in the world in winter as people use coal-burning stoves; energy generation is primarily from coal; and – for all its economic benefits – resource exploitation has the potential to cause significant environmental damage.

In Mongolia’s democratic context, these issues have a greater visibility than in other Central Asian states. In practice, corruption, lack of enforcement of regulations and other barriers mean that these issues are still challenging.

Specific considerations for foreign investors
Foreign investment flows have been highly variable, reflecting the global commodity price cycle and the policy stance of the Mongolian government. FDI fell from US$ 4.7 billion in 2011 to US$ 218 million in 2016. The main investing countries are China, Canada, Russia, the UK and the USA. Investments are mainly in mining, oil and construction. In particular, the Oyu Tolgoi gold and copper mine has the potential to make up one-quarter of Mongolia’s GDP, but has been beset by disputes on tax payments, economic arrangements and protests.

Foreign investors have felt persistently disadvantaged in the Mongolian court system and in the enforcement of contracts. Foreign business-people have also been subject to apparently arbitrary detention and prevented from leaving the country during the course of slow dispute resolution (‘exit ban’). Investor trust and confidence has been undermined by the revoking of 106 licences in 2014 as part of a corruption investigation, in response to popular nationalist sentiment.

Since that time, the government has committed itself clearly to addressing foreign investor concerns. The government signed the Agreement on Transparency in Matters Related to International Trade and Investment between the United States of America and Mongolia in 2017. FDI inflows recovered in 2017 to US$ 1.5 billion, with a total stock of US$ 18.0 billion. Oyu Tolgoi II is now underway, though progress remains slow, with political disputes over tax and how to implement the commitment to build local power generation.

The government has replaced the Invest Mongolia Agency with a new National Development Agency, but has not yet implemented all measures relevant to foreign investors.

The continuing, ambiguous nature of business regulation creates a risky environment where corruption and government relations are the usual means to resolve issues. This poses significant challenges for many foreign investors. Government-to-government discussions are important, but only happen in a context of asserting Mongolia’s autonomy among strong neighbouring powers and keeping popular sentiment supportive in a lively democracy.

Foreign exchange and capital controls risk for foreign investors
The Mongolian tugrik is fully convertible into foreign currency. It is largely free floating. The resulting volatility causes some risks to unhedged foreign investors and banks exposed to a large currency mismatch.
Security risk

According to the Global Terrorism Index 2017, Mongolia ranks at 130, with an Index value of 0, and a threat level of “no impact”.

Although the global risk of indiscriminate terrorist attacks cannot be ruled out, Mongolia has not recently experienced terrorist violence or faced any immediate threats from terrorist groups inside the country or across its borders. A neutral geopolitical stance, combined with a dispersed population, contribute to the low threat level.
Tajikistan

Overview

Tajikistan struggled with poverty and instability in the decade after the end of the Soviet Union. President Rahmon has had a firm grip on power since 1994, having restored some stability to his country. Tajikistan remains dependent on Russia, however, both economically and to help address security challenges. China has become increasingly active in the country, financing infrastructure and investing in energy and resources. The main foreign investors in Tajikistan are now China, Russia and Kazakhstan, followed by the UK and the USA. In the past three years China has also initiated a programme of military-to-military confidence-building, with the transfer of security hardware mainly directed to border control.

Moody’s issued its first rating of B3 for Tajikistan in 2017. Economic challenges remain in the banking sector, following a bail-out in 2016, which resulted in increased fiscal burdens. The external debt burden has also been rising rapidly, in particular as a result of borrowing from China.

Tajikistan is not considered an easy place to do business. It ranks 123rd out of 190 countries in the World Bank’s 2018 Ease of Doing Business index. Particular challenges are bureaucratic and ambiguous processes, and poor access to energy and credit. Corruption remains a major challenge for foreign and domestic businesses; Tajikistan ranks at 161 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017.

While the government is keen to attract foreign investment, investors still find the country a challenge. Success for foreign investors is currently highly dependent on effective relations and support at the most senior levels of the Tajik government.

Sovereign risk: Macroeconomic, political and security risk

Moody’s assigned its first rating to Tajikistan in August 2017, with a rating of “B3, stable outlook”. It also assigned a cap of B1 on any credits issued by any entities in the country. This accompanied the launch of Tajikistan’s first sovereign debt issue, a US$ 500 million Eurobond to finance the Rogun dam.

This rating reflects an assessment of potential robust medium-term growth, based on hydropower generation, combined with credit challenges posed by institutions that are weak on a global scale, despite some progress on reform. External vulnerability risks are also seen as significant, as a result of low foreign exchange reserves, a rising government debt burden and the contingent risks posed by the weak banking sector. Tajikistan’s debt-to-GDP ratio has risen from 3 per cent of GDP in 2015 to a forecast 57 per cent in 2018. China, the country’s largest creditor, accounts for almost 80 per cent of this increase over the period 2007 to 2016.

With President Rahmon in power since 1994, Tajikistan has become a more stable country. There was, however, an attempted coup in 2015, while security challenges linked to drug smuggling from Afghanistan and to Islamist extremism remain real and significant.

IMF visits in 2017 and 2018 identified a need to improve financial sector regulation and supervision; the significant fiscal risks resulting from public infrastructure investments; and the need for overall supervision of state-owned-enterprise-related risks.

Business environment risk: Project implementation and operational risk

Tajikistan ranks 123rd out of 190 countries in the World Bank’s 2018 Ease of Doing Business index. Overall, processes and approvals are burdensome and slow. Tax demands have become increasingly heavy-handed and arbitrary as fiscal pressures increase the need for government to secure revenue.

Areas of particular challenge for businesses are: availability of electricity (171st); trading across borders (149th); resolving insolvency (148th); dealing with construction permits (136th); paying taxes (132nd); and access to credit (122nd). Tajikistan’s relative strengths are in: protection of minority investors (33rd); enforcing contracts (54th); starting a business (54th); and registering property (90th).

More broadly, the government plays a significant role in all aspects of the economy and business. Regulations are broad but often unclear, with the US government observing over 200 different strategies and sectoral development programs. Overall business skills are also limited within the country’s workforce.
Corruption levels are high: Tajikistan ranks at 161 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017. While legislation to combat corruption was passed in 2016, enforcement is highly selective and is generally ineffective in combating the corruption of public officials. This acts as a significant barrier to many foreign investors.

Financial sector: Credit, interest rate and market risk

Financing within Tajikistan is through the banking sector, with no meaningful domestic capital markets. The banking sector remains weak, with high levels of non-performing loans, poor data and weak oversight. Solvency and liquidity problems remain following bank bail-outs in 2016. Further reform remains a high priority. In the meantime, credit assessment and market-based allocation remains undeveloped.

Sustainability: Environmental, social and climate risk

Tajikistan faces significant environmental and climate challenges. Intensive use of chemicals and irrigation in order to increase cotton production during the Soviet era led to high levels of soil salinisation and desertification. Deforestation is also a concern. Moreover, the limited nature of civil society and NGO activities limits the monitoring and management of potential issues.

Specific considerations for foreign investors

The Tajik government is keen to attract increased foreign investment into new and existing industries. Recently, China has taken over from Russia as the largest foreign investor, followed by Kazakhstan as the third-largest and then the UK and the USA.

Overall, however, foreign direct investment remains very low. The total stock in 2017 was an estimated US$ 2.6 billion, with an annual inflow of US$ 141 million in 2017, down from US$ 397 million in 2015. The main receiving sectors are aluminium, cotton and energy, with some future potential in tourism. There is also significant borrowing from overseas in order to fund infrastructure and energy investments: China is the largest creditor, with Tajikistan owing over US$ 1 billion to China Exim Bank as of 2016.

Legally, there are no laws that discriminate against foreign investors. Indeed, Article 4 of the Investment Law guarantees equal rights for local and foreign investors. However, this has little meaning in practice in light of weaknesses in implementation of the rule of law; the government’s heavy involvement in all aspects of business; the importance of personal connections; and corruption. For example, the State Committee on State Property Management and Attraction of Investments coordinates the screening of all foreign investment proposals in a long and difficult process.

The ambiguous nature of business regulation creates a risky environment, where corruption and government relations are common means to resolve issues. This poses significant challenges for many foreign investors and means that others need to rely on government-to-government as a key part of risk mitigation in their investment strategies.

Foreign exchange and capital controls risk for foreign investors

Currency controls were implemented in 2015 and remain in place. This limits accessing foreign exchange, and the inconvenience of doing so when it is permitted are a constraint on investment and cross-border activity.

Security risk

According to the Global Terrorism Index 2017, Tajikistan ranks 72nd, with an Index value of 2.427, and a threat level of “low/med”. The negative economic effects of poverty and unemployment are facilitating extremist recruitment and separatist tendencies in Tajikistan. Calls for jihad are not only affecting the poorest levels of the population, but also high-ranking officials in the Special Forces. In 2015 the Tajik Colonel Gulmurod Khalimov, Head of Tajikistan's Special Assignment Police Unit, switched sides in favour of ISIS. A clear and present danger is posed by narcotic smuggling and the level of government corruption it entails. Tajikistan is the primary transit country for Afghan narcotics from the Kunduz province to Russian and eastern
European markets. The USA, Russia and the EU have all supported Tajikistan’s border forces; recently China joined in with support for military hardware and training. Unfortunately, success in these ongoing counter-drug efforts is proving difficult due to the sheer length of the border size, the difficulty of the terrain, and endemic corruption.

The presence of a Russian military base and of Russian border guards provides reassurance in the face of the terrorist threat. Nevertheless, in the summer of 2018 ISIS affiliates claimed responsibility for its first attack inside Tajikistan, culminating with the killing of Western tourists.
Turkmenistan

Overview

Today, the economy rests on sales of gas and oil, as Turkmenistan has the world’s fourth-largest proven gas reserves. The country has, however, been significantly hit by the fall in the world gas price, creating social and economic strains. Turkmenistan’s defining foreign policy is its neutrality, which considerably narrows its ability to engage in international cooperation in the security sphere.

A National Development Plan for 2018-24 was adopted in October 2017. One important element is the development of the private sector both in farming and in small and medium-sized enterprises, together with increased exports and reduced imports. The government also wishes to attract more foreign investment and – with the country’s extensive natural resources – there remains interest among foreign investors in finding ways to invest.

However, the business environment is challenging, dependent on government relations and subject to ongoing regulation and involvement of government in key decisions. Turkmenistan is not ranked in the World Bank’s Ease of Doing Business index, due to a lack of reliable data – an indicator of the challenges that businesses face. Turkmenistan ranks at 167 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017.

Success for foreign investors is currently highly dependent on effective relations and support at the most senior levels of the country’s government. Companies have left Turkmenistan following non-payment of contracted bills by the government and in light of problems repatriating foreign exchange.

Sovereign risk: Macroeconomic, political and security risk

Turkmenistan does not currently have an internationally accepted sovereign rating issued by a Western firm. Moody’s withdrew its rating in 2010. Dagong Global Credit Rating issued a rating of “BBB+, stable outlook” in 2013. This was downgraded to “BBB+, negative outlook” in 2016. This downgrade resulted from the impact of lower energy prices on the government’s fiscal position; increasing debt; and an overvalued exchange rate. Dagong remained positive, however, on the value of Turkmenistan’s natural reserves.

The IMF staff visit in March 2018 reinforced that the main near-term policy challenge is to reduce external imbalances, through exchange rate adjustment and fiscal and monetary tightening, together with market reforms to create a more business-friendly environment.

Turkmenistan’s political system remains stable under the personal rule of President Gurbanguly Berdimuhamedov. The government does not permit opposition and maintains a tight grip on all politically sensitive issues. In security terms, there have been no recorded examples of damage to projects and installations. The recent fall in the gas price does, however, pose a challenge to social stability.

Business environment risk: Project implementation and operational risk

The business environment is highly challenging and dependent on effective relations with the government at the highest levels. All land is owned by the government and other ownership rights are limited. State-owned enterprises predominate and there is no meaningful private sector activity independent of government. The government is actively involved in many day-to-day business decisions.

Day-to-day business is burdened by excessive and inconsistent regulations, slow decision-making and the lack of basic technology support such as well-developed internet and phone services. Contracts are hard to enforce: the judiciary is not independent nor is there independently established rule of law. The president can and does appoint and remove judges through direct intervention.

Absence of reliable macroeconomic data hinders effective business decision-making: commentators note divergence between on-the-ground observations and the official data that is published. Reliable data on business counterparties is not available. Business decisions and risks therefore rest on relationships and willingness to take information on trust rather than analysis.

Overall, corruption levels are high: Turkmenistan ranks at 167 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017. Corruption is especially widespread in government procurement, the awarding of licences and in customs processes. While legislation to combat corruption does exist, it is not generally enforced.
Financial sector: Credit, interest rate and market risk

Financial risks are for the most part the result of the other macroeconomic and business risks. In addition, financing and bank lending decisions are highly directed by the state, with a very limited role for market intermediation. This applies both to lending and to questions of whether loans are non-performing.

Membership of the quasi-state Union of Industrialists and Entrepreneurs of Turkmenistan is a key criterion for access to contracts and state loans. Risk-based loan pricing is not widespread. Banking supervision is currently inadequate. The absence of domestic capital markets means that market risk in itself is not relevant for consideration.

Sustainability: Environmental, social and climate risk

Potential environmental risk is significant due to the importance of energy extraction and transportation combined with an opaque, relationship-based operating environment. While environment-related laws have been passed, implementation is at best variable and mostly depends on the standards that foreign investors implement.

The extremely limited nature of civil society and NGO activities limits monitoring and management of potential issues. There is no distinctive risk associated with climate change in the short term, but the looming desertification process is poised to create long-term constraints.

Specific considerations for foreign investors

Turkmenistan’s government is keen to attract foreign investment in order to diversify the economy and become less dependent on natural resources. However, the investment environment remains challenging for foreign investors, with government relations being key, while the greatest interest remains in the natural resources sector.

Total FDI stock reached US$ 34.2 billion in 2017, with inflows of US$ 2.3 billion in that year. China, Russia, Kazakhstan and Uzbekistan are the main investors, with oil and gas, agriculture and construction the main investment sectors. China is increasing its investment, especially in the gas sector and is the largest buyer of the country’s gas. China has lent US$ 4.1 billion to develop the world’s second-largest gas field there, the Iolotan field.

Legally, there are no limits on the foreign ownership or control of companies. However, in practice, foreign investors only gain access by being selected by the government as a partner and then are reliant upon the government for their financial returns. The Agency for Protection from Economic Risks is tasked with reviewing all foreign investment interest, including an assessment of the financial and political risks associated with allowing the company to do business in Turkmenistan. This agency itself makes opaque and often arbitrary-seeming decisions. Fully owned foreign operations have only been allowed in the oil and mobile telecommunications sectors. In addition, citizens of Turkmenistan must account for 90 per cent of the workforce of a company owned by a foreign investor.

Despite the government’s encouragement to invest, commercial law does not generally meet international business norms. Even where amendments are made to law in line with international standards, implementation through the courts is not possible in practice. The only commercial code adopted is the Law on Trade Activity of 2016.

Foreign investors face many risks and controls, and thus financial risk. At the most fundamental level, companies have left Turkmenistan following non-payment of bills by the government and the inability to repatriate foreign exchange. French (Bouygues), South Korean (Hyundai) and Turkish (Polimeks) firms all faced non-payment problems in 2016 as gas revenues fell. In December 2016, the government expropriated the largest (the only foreign-owned) grocery store, Yimpas, without compensation or legal remedy.

Cross-border trade is difficult, with tight controls and heavy administrative processes covering contract registration and pricing approval. For example, customs stamps were re-introduced in June 2017, requiring importers to obtain a stamp from the State Commodity and Raw Materials Exchange before customs clearance.

The ambiguous nature of business regulation creates a risky environment, where corruption and government relations are frequently used to resolve issues. This poses significant challenges for many
foreign investors and means that others need to rely on government-to-government liaison as a key part of risk mitigation in their investment strategies.

**Foreign exchange and capital controls risk for foreign investors**

Capital controls are tight, and repatriation of earnings is dependent on government decisions. The official exchange rate is highly overvalued. Exchange controls mean that there is a large divergence between the black market and official peg rates. This in turn has led to even tighter foreign exchange controls, and a further drag on private sector development.

**Security risk**

According to the Global Terrorism Index 2017, Turkmenistan ranks at 130, with an Index value of 0 and a threat level of “no impact/not included”.

Turkmenistan is perceived to suffer less from Afghan instability than Tajikistan and the Kyrgyz Republic, but it is difficult to acquire updated information about the area. Turkmenistan’s external security efforts have been devoted to border-strengthening in order to contain the Taliban and the IS threats coming from northern Afghanistan. An IS incursion from Afghanistan in 2017 caused considerable concern.
Uzbekistan

Overview

Following President Karimov’s death in 2016, President Mirziyoyev is leading Uzbekistan in a much-trumpeted programme of economic, government and political reform. The currency liberalisation in September 2017 was accompanied by a large devaluation of the official exchange rate, but set out the basis for increasingly open approach to trade and investment.

Improving the business environment is a top priority. Reform has already made Uzbekistan one of the world’s fastest improvers in the World Bank’s 2018 Ease of Doing Business index, and it is the regional leader among its neighbours, currently ranking 74th out of 190 countries globally. Corruption remains a major challenge for foreign and domestic businesses, with Uzbekistan ranking at 157 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017.

The new leadership is very keen to attract foreign investment. To date, FDI has been very limited, but China and Russia have announced multi-billion dollar investments, as have Japan and South Korea. The establishment of special economic zones with tax incentives have helped to make the investment climate more attractive. For the time being, however, most major investment discussions are government-to-government in nature.

Sovereign risk: Macroeconomic, political and security risk

The May 2018 IMF Article IV consultation welcomed the comprehensive reform programme, the liberalisation of foreign exchange and prudent fiscal policies that were keeping debt low.

Moody’s has maintained ratings of individual Uzbek banks, while an assessment for a sovereign rating is underway.

Dagong last issued a rating of “BBB-, stable outlook” for Uzbekistan in 2016, ahead of President Karimov’s transition. This rested on Dagong’s assessment of a stable political environment, combined with a relatively weak economy, a government fiscal deficit and a rising, though still low, debt burden.

In terms of political risk, Uzbekistan is stable. The transition from Karimov’s 27-year rule was smooth. Mirziyoyev remains in tight control of the country, although there are some moves to liberalise the media and allow limited opposition. There are some security challenges from Islamist extremist movements.

Business environment risk: Project implementation and operational risk

Uzbekistan’s business environment continues to improve significantly and rapidly. In the 2018 World Bank Ease of Doing Business report it lies in the middle of the pack, with a ranking of 74th out of 190 countries, and is one of the strongest improvers. Reform is underway in the business environment and in a strengthened judiciary.

Uzbekistan performs relatively well in terms of starting a business (11th); availability of electricity (27th); enforcing contracts (39th); access to credit (55th); and protecting minority investors (62nd). Particular priorities for reform are: trading across borders (168th) and dealing with construction permits (135th). Regulations and the tax system remain complex and unwieldy, but a new tax system is being developed. Government interventions in business decisions on a day-to-day business have declined: a two-year moratorium on unscheduled inspections of businesses was announced in January, unless there is evidence of a crime.

Corruption levels remain significant, however. Uzbekistan ranks at 157 out of 180 countries in Transparency International’s Corruption Perceptions Index 2017. Changing this will take time and require further, specific measures such as the inspection moratorium. In 2017, a new anti-corruption law was introduced, but consistent implementation will be critical.

Data reliability and availability remain an issue for business decision-making. However, the government has made significant steps in improving this already and will continue to do so.

Financial sector: Credit, interest rate and market risk

Financing is primarily through the banking sector, although there is a domestic stock market. The banking system is a mixture of state-owned, partly state-owned, private and foreign banks. The bulk of financing was until recently state-directed rather than market-based. Under reform plans, the intention is to move
more clearly towards market-based intermediation. Credit risk assessment and management capabilities are currently limited, as is the use of risk-based pricing. Getting access to credit is, however, a less significant challenge for business than in neighbouring countries. Likewise, overall capitalisation of the sector is not a significant concern.

Sustainability: Environmental, social and climate risk

Uzbekistan faces environmental issues in two principal areas. First, a legacy of excessive water use, irrigation and use of chemical fertilisers has led to soil salinisation, soil poisoning, desertification and the evaporation of the Aral Sea. Second, the increased exploitation of its energy resources has the potential to cause further damage if appropriate standards are not specified and enforced. Under Mirziyoyev, the State Committee for Environmental Protection has been reformed and taken on a more prominent role. There is active engagement with the United Nations Development Programme and some NGOs on environmental questions.

Specific considerations for foreign investors

Transforming Uzbekistan into an attractive foreign investment destination is an important priority for the government. Historically, FDI has been very low, amounting to US$ 96 million in 2017, with a total stock of US$ 9.3 billion. In 2011, China launched a pipeline extension project linking Uzbekistan to the Central Asia-China gas pipeline.

Significantly larger sums are now being discussed in relation to major infrastructure, energy and resources projects, mostly in the form of debt financing. China has pledged US$ 5 billion to infrastructure and mining, South Korea is building a US$ 2.6 billion chemicals plant. Japan is contributing US$ 5 billion towards exploration of hydrocarbon deposits. Russia is seeking to construct a nuclear power plant. Future Chinese investments worth up to US$ 20 billion are rumoured to be under consideration, while the equivalent figure for Russia is thought to be US$ 10 billion. The World Bank and other organisations are also increasing their lending.

To make the country more attractive to investors, the government has launched seven special economic zones with tax incentives. It is also planning to raise US$ 600 million through a Eurobond issue to establish a benchmark and also to finance infrastructure.

Uzbekistan has high barriers to cross-border trade. Reducing these rapidly will be important to increase the country’s integration into the regional and global economies. Progress includes new border crossings with Kazakhstan and moves to resolve tensions with Tajikistan and the Kyrgyz Republic.

To date, the largest investment initiatives under discussion come from government-to-government negotiations, to be implemented primarily by foreign state-owned enterprises. However, private sector foreign investors have the potential both to benefit from Uzbekistan’s ongoing reform, and to contribute to it. Equally, support from the government of Uzbekistan remains critical to business success.

Security risk

According to the Global Terrorism Index 2017, Uzbekistan ranks 125th, with an Index value of 0.077 and a threat level of “no impact”.

The largest Islamist radical group in the region, the Islamic Movement of Uzbekistan (IMU), is however operating in Uzbekistan. In Tashkent, the Regional Anti-Terrorist Structure (RATS) has been established. With more than 1,000 fighters, IMU operates from camps in northern Afghanistan and is fomenting skirmishes in the border areas of the Kyrgyz Republic and Tajikistan, as well as more coordinated attacks in Uzbekistan. In the past few years the group’s activities have expanded into the Middle East. At regional level, Uzbekistan’s military and security forces are considered to be relatively capable.
Annex 2. Data

Chart A.2.1. GDP by country, 2017


Chart A.2.2. Population by country (million), 2017

Chart A.2.3. FDI (US$ billion), 2017


Chart A.2.4. FDI stock (US$ billion), 2017

Chart A.2.5. GDP per capita (US$), 2017


Chart A.2.6. Ratio of FDI to GDP, 2017

Chart A.2.7. Sovereign risk, 2018

Source: Moody’s (2018)

Chart A.2.8. Ease of doing business, 2018


Chart A.2.9. Corruption Perceptions Index 2017

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