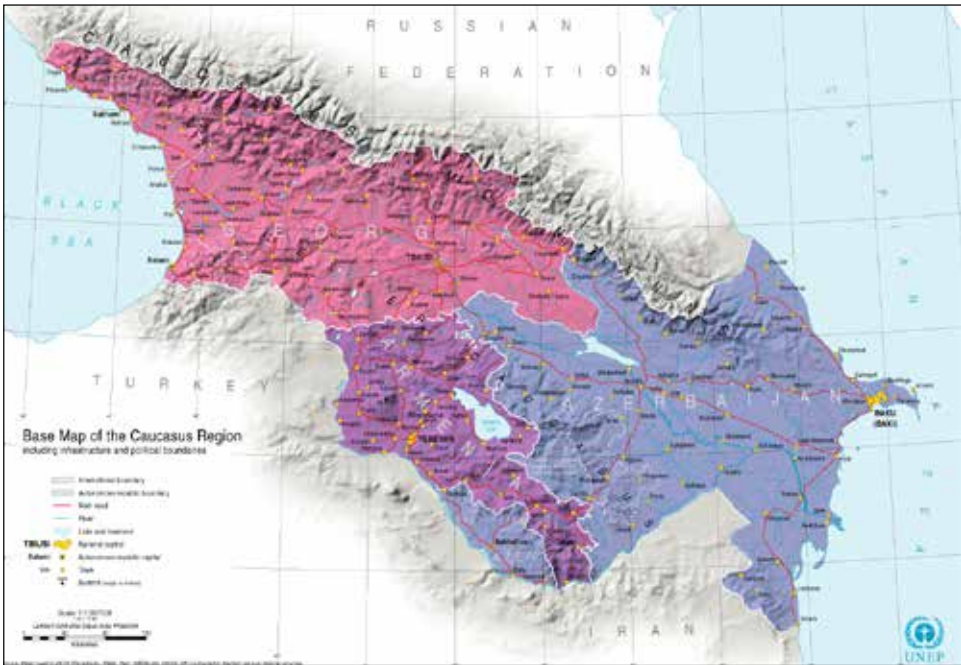


The South Caucasus

Between integration and fragmentation

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Fuad Chiragov
Kornely Kakachia
Andrey Makarychev
Mehmet Ögütçü
Amanda Paul
Zaur Shiriyev

Vusal Gasimli
Reshad Karimov
Farhad Mammadov
Gulshan Pashayeva
Dennis Sammut
Cavid Veliyev

China in the South Caucasus: not a critical partnership but still needed

Mehmet Ögütçü

From the dominance over important global resources such as oil and gas in the Caspian Sea, to security fault-lines, to control over communication/transportation routes between the East and West, and the North and South, the South Caucasus holds great geo-strategic importance.

However, the Caucasus has remained a relatively low-priority region for China. China's interests in the South Caucasus are essentially derived from its wider foreign policy goals, particularly given the relatively small size of the potential market, all 17 million citizens that it represents: securing access to new sources of raw materials where possible; creating a stable environment around China's extended periphery; building trans-continental transportation links; and to an extent, opening up new markets for Chinese companies to expand into.

Trade and investment ties between China and this region are on the increase. Given the proportional size of Western, Russian and Turkish economic interests in Azerbaijan, China remains a relatively minor player for the time being, ranking only 10th among Baku's external trading partners. Chinese companies have evidently chosen to focus for now on niche areas where the competition is less severe – e.g. development of oil production at some of Azerbaijan's ageing (and thus less commercially attractive) on-shore fields (e.g. Salyan, Garachukhur, Gobustan), and upgrading a hydro-electric power plant at Mingechaur. Regular flights operate between Baku and Urumchi, capital of China's western Xinjiang autonomous region.

Trade turnover between China and Azerbaijan has grown 800-fold during 22 years of diplomatic relations.¹ In the first years following the establishment of diplomatic ties, bilateral trade amounted to only \$1.5 million and jumped in 2004 to \$200 million and \$368 million in 2006. Currently, bilateral trade is around \$1.5 billion.² The trade with Xinjiang accounts for a third of the total turnover between Azerbaijan and China. To date, more than 20 agreements have been signed between the two countries. Sixty-nine Chinese companies are now operating in Azerbaijan, mainly in trade, construction, agriculture and communications.

The scale of China's overall presence in the region is modest compared to the inroads it has made into Central Asia, with energy, security and transportation interests in mind. Consequently, the growth in Chinese economic and political interests in the South Caucasus (expanding rapidly, albeit from a low base) has so far gone largely unnoticed.

Yet, the place of Caucasus in China's calculus should not be treated in isolation of Beijing's engagement with the West, Russia, Iran and Turkey in the region. Beijing's growing presence has entailed an economic and political reorientation of the South Caucasian states towards closer (and possibly even strategic) partnerships with China, causing some readjustment in the relative position of other regional players. To some very limited extent, this process could mirror the related developments in Central Asia, where China's growing investments and

trade activities are gradually translating into Beijing's enhanced political leverage and pushing other traditional regional actors, including Russia, to the sidelines.³

Having no direct borders with the region, its political cooperation with the South Caucasus is also far less developed than in the case of Central Asia – in particular, there is no South Caucasus equivalent of the Shanghai Cooperation Organisation to serve as a mechanism for China's engagement with the region.

Yet, China is able to approach the South Caucasus unencumbered by some of the negative 'baggage' that affects its relations with its Central Asian neighbours. Unlike in Central Asia, China by definition can have no disputes with the South Caucasus countries over border delineation or water management issues. Nor are there any active concerns on China's part regarding the South Caucasus's role as a haven for Uyghur separatists that pose a security threat to its Xinjiang-Uyghur Autonomous region. And, in contrast to Central Asia, where popular suspicions of China are increasingly visible, there is little evidence to date of widespread concerns in the South Caucasus over the prospect of being 'swamped' by China.

Both Moscow and Beijing are keen on keeping the West out of this region and therefore support the idea of a Sino-Russian partnership to counter the US power in this region, at least in the foreseeable future, while both is likely to have divergence of interests in the longer term. Therefore, geopolitical competition between the US on the one hand, and Russia and China on the other to influence the region is destined to continue in the coming decades.

The South Caucasus states generally view China in positive terms, as an increasingly important trading partner and a source of much-needed investment. Moreover, unlike western countries or Russia, China has the welcome characteristic of 'accepting the host countries as they are' – i.e. it does not bring with it any 'hostile agenda' of its own over human rights, investment climate issues, Eurasian integration.

The South Caucasian states are worried about Russia's aggressive strategy and use of force in the post-Soviet sphere of influence, which was clearly shown during the 2008 war in Georgia and 2014 annexation of Crimea, which reinforced their wary attitude to Russian initiatives and its policy. The Crimean crisis and President Putin's remarks on Kazakhstan as well as Moscow's new policy *vis-à-vis* CIS citizens of Russian ethnic origin give rise to serious concern. China's increased role in the region offers the benefit for all three South Caucasus states of creating a certain degree of leverage to use in their dealings with other outside powers – first and foremost Russia, but also to some extent the US and EU.⁴

Energy, trade, investment and infrastructure

China's intensified search for resources, trade and transport corridors to fuel its booming economy will likely lead to enhanced cooperation between Beijing and the South Caucasian states, pointing to a number of implications for the region and its traditional actors.

Unlike in Kazakhstan and Turkmenistan, China has no energy investments of geo-strategic significance in the South Caucasus at present. China's emergence as serious investor in the

early 2000s came too late for it to compete with major IOCs for stakes in the country's most attractive oil & gas projects.⁵ Its main attempt to rectify this was made in 2010, when China's Sinopec expressed interest in taking over the 5.6% share of the US's Devon Energy in the international consortium operating the giant Azeri-Chirag-Guneshli oil & gas project (eventually the stake was sold to BP for \$2 billion).

Although no more than a theoretical idea, a Trans-Caspian Gas Pipeline capable, in principle, of shipping Azeri gas into Central Asia and onwards to China had been publicly discussed. To date however, there is no evidence of serious negotiations having been held over such a possibility as Turkmen, Kazakh, Uzbek and Russian gas will be more than enough for China's needs.

Armenia, the region's smallest state by GDP, has in proportional terms the most significant economic relationship with China, which is currently its third largest trading partner after the EU and Russia – bilateral trade with China was valued at \$317 million in 2011.⁶ Although the majority of this is accounted for by Chinese imports, China is also looking to increase its role as an investor in Armenia.

Chinese companies have refurbished two thermal power plants in Armenia in recent years, and talks have been held (albeit so far without concrete results) regarding Chinese participation in a planned new railway between Armenia and Iran. There is also evidence of Chinese interest in mining for rare elements in Armenia, particularly molybdenum. Unusually, there is also one case of a reverse project within China (in its northern Shanxi province), where a joint Chinese-Armenian rubber factory operates using Armenian-supplied technology.

Back in 1999, media reports indicated that China had agreed to supply Armenia with eight 'Typhoon' missile systems. However, it is unclear whether these were in fact delivered, and China evidently concluded afterwards that its interests would be best served by refraining from supplying weapons to either side in the conflict over Nagorno-Karabakh.

Officials in Beijing, having realised the potential negative consequences of the scandal, rushed to apologise – quickly blaming private Chinese companies for the mistake.⁷ The Chinese government promised not to repeat the same mistake in the future. Indeed, the entire scandal once again showed that China was not interested in becoming involved in the conflict. Furthermore, economic and energy cooperation with Azerbaijan seemed much more attractive to the Chinese leadership than its ties with Armenia.

China's presence is the most diversified of all in **Georgia**, for whom China is currently its fifth largest trading partner. Chinese companies have invested here in raw materials (timber production and marble mining), electricity (construction of a hydro-power plant in Kakheti, eastern Georgia) and infrastructure (refurbishment of Rikoti tunnel on Georgia's main east-west highway). There is also expressed Chinese interest in investing in copper mining, a railway bypass route around Tbilisi, and in a free-trade zone in Kutaisi.

Chinese officials have announced plans for China's total level of investment in Georgia to reach \$1.7 billion by 2017. Alone among the South Caucasus states, there are signs of a putative popular reaction against this expansion of China's presence, in particular over the

sharp and visible increase in the number of Chinese migrant workers entering the country as a result.⁸ A small public protest over this latter issue, organised by a fringe group of Georgian nationalist parties, was held in Tbilisi in February 2013.

Rail "Silk Road" through the South Caucasus

Beijing announced plans to develop a high-speed railway system that would promote China's exports to Europe through what is an efficient and extremely fast transportation network, thus enhancing the position of the Caspian and South Caucasus regions as regional interconnectors.

The real impetus to China's relations with this region will likely come when the Kars-Akhalkalaki-Baku railway, connecting Asian and European railway systems, will be completed. This trans-continental railway, discussed during President Aliyev's visit to Beijing in March 2005, will likely increase the Chinese presence and trade opportunities in the South Caucasus region.

This rail link from western China to Turkey via Central Asia, Azerbaijan and Georgia (with a ferry link across the Caspian Sea from Turkmenistan to Baku) has been floated as a top initiative designed to revive the concept of a 'Silk Road' transportation network linking China to Europe via the Caspian region. From Beijing's standpoint, the potential attraction of such a route lies in its contribution to diversifying China's access to international markets and reducing its vulnerability to disruption of sea-based exports.

After the completion of the railway, it is expected that the transportation of goods from Europe to China will be twice as cheap and transport time will be reduced significantly. Overall, the trade turnover through this new railway-corridor is expected to reach nearly 20 million tons per year.⁹

However, financial, technical, bureaucratic and political problems stand in the way of this transportation initiative. Also, Armenia opposes this strategic project, insisting on the use of Kars-Gyumri-Tbilisi link that has not functioned since the closure of the Turkish-Armenian border in 1993. For Tbilisi, which seeks to position itself as a regional transit corridor, this project is important and supports it strongly. While the Chinese-backed project is still underway, the Western-supported Transport Corridor Europe-Caucasus-Asia (TRACECA) and Central Asia Regional Economic Cooperation (CAREC) regional transportation projects are also proceeding.

China on the regional issues and disputes

In sharp contrast to some other major powers, China's leaders are prepared to deal with the governments in the Caucasus countries without challenging their domestic arrangements or approach to democracy and human rights. They focus exclusively on economic and geopolitical interests from a realist perspective, something that governments in the region appreciate especially as they have been stung by the criticism of others.

To the south Caucasus and the "frozen conflicts", namely between Georgia and the Russian Federation, and between Armenia and Azerbaijan, China brings its unique experience of

working with Taiwan, a place that Beijing insists is *de jure* part of China, but one that it interacts with as a *de facto* independent country. For Tbilisi, Moscow, Baku and Yerevan, that experience is at least suggestive of some of the possible ways forward in dealing with the so-called "breakaway" republics of Abkhazia, South Ossetia and Karabakh.

At the same time, the region is beset by growing anger in Baku about the Organisation for Security and Cooperation in Europe (OSCE) Minsk Group's failure to resolve the Karabakh conflict, ongoing fears in Tbilisi that Moscow will continue to back Abkhazia and South Ossetia. As a result, China might be asked to play some role in both cases, but few in the region and quite possibly few elsewhere or even in Beijing itself now foresee this.

The growing cooperation between the South Caucasus and China will necessarily involve Central Asia, which is itself witnessing China's rapid rise in its neighbourhood. While the South Caucasus is a corridor for the West's energy resources in Central Asia, Central Asia is a transit point for China to the energy-rich Caspian and South Caucasus regions. This offers significant opportunities for the Central Asian region, which can effectively capitalise on its rapidly expanding role as a conduit of continental trade and platform for investments in the transportation sector. The resolution of Central Asia's complex border, water, and security issues is nevertheless a key to reigniting the region's potential in spurring East-West energy, trade and transportation flows to the benefit of all parties.

While maintaining the vital strategic interest in Central Asia, China does not express a similar high interest towards South Caucasus. The Central Asian region is of great strategic significance to China. It is not only a barrier for security guarantee in western China, but also a buffer zone between China and Russia and between China and regional powers such as Turkey and Iran.

China's "balanced" position on Nagorno-Karabakh, South Ossetia and Abkhazia serve its interests well, with the regional states returning the favour by supporting the "one China" policy and Beijing's regional economic presence.

Some commentators have suggested that as China's economic footprint in the South Caucasus expands, it will eventually wish to become more directly involved in conflict-resolution processes there. Specifically, in relation to Nagorno-Karabakh, the notion has been put forward that China might usefully seek to promote the 'one country, two systems' policy that it has adopted with regard to Taiwan as a possible basis for a peaceful settlement of the dispute.¹⁰

To date however, there is no evidence of any official interest from Beijing in pursuing such a role. Although China generally defers implicitly to Russia in this part of the world, it is not prepared to do so unconditionally when it feels its national interests are at stake (as was the case with Moscow's recognition of South Ossetia and Abkhazia). At the level of military cooperation with the Central Asian and South Caucasian states, China cannot compete with Russia and the US. Beijing has no military bases in the region.

Over Nagorno-Karabakh, Beijing did not want to involve or assist any side; it maintained political neutrality and recognised the official policy of the UN. This implied that China

followed the international community's recognition of Azerbaijan's territorial integrity with Nagorno-Karabakh being under Azerbaijan's jurisdiction. Prior to Aliyev's 1994 visit, China already backed the UN Security Council's resolution demanding the unconditional withdrawal of Armenian military formations from the occupied Azerbaijani territories. Indeed, China's support of Azerbaijan's territorial integrity was of great importance for the newly independent country.

China's political interests in the South Caucasus are largely indirect ones (most notably averting the even theoretical possibility that pan-Turkic elements promoting Uighur separatism might gain a foothold in the region, of which there is no sign at present). Beijing shows no appetite for involvement in attempts to solve the region's conflicts, and in general appears content (as in Central Asia) to defer to Russia in dealing with the region's internal politics.

Russia is pressuring its neighbours to join the Eurasian Economic Union (EEU). Moscow worries, with reason, that the South Caucasus countries prefer to align with the European Union. While Armenia recently joined the EEU, there is presently little sign that either Azerbaijan or Georgia will follow suit. However, Moscow's dispute with Ukraine and veiled threat to Kazakhstan could presage tougher stances with other neighbours.

Russian influence in the independent states of the South Caucasus (and Central Asia) will remain strong. Economic pressure, energy dependence, multilateral groupings, diasporas and the re-application of a Russian cultural education are all used to sustain the old but recently revived fantasy of a Eurasian Union.

But these countries have been looking for alternative ties to reduce Moscow's influence. In the South Caucasus, Armenia has already succumbed to Russia economically and in the security realm, with ramifications for its sovereignty. But Azerbaijan and Georgia, via different paths, have tried hard to move away from Russia's embrace. In Central Asia, the overall picture is more complex, especially with the relatively enhanced Chinese presence. But Kazakhstan is leading a multi-dimensional strategy and the other Central Asian states are following in their pursuit of new partners and increased room for manoeuvre in economic and foreign policy areas.

Prospects

Clearly, despite its limited geostrategic interests, China is interested in the South Caucasus for the expansion of trade with the petroleum-rich Caspian basin countries, the establishment of land-based transportation and communication links between Asia and Europe, the recognition of China as a rising super power, and, above all else, political stability. China is not at ease with Russia's takeover of Crimea, given that it has a number of secessionist claims to deal with (Taiwan, but also Xinjiang and Tibet). The South Caucasus is riddled with these problems. It might be difficult for China to remain silent on these issues.

In the South Caucasus as in other regions, China takes a long-term approach to all issues also linked to Beijing's strategic engagement with the West, Russia, Turkey and Iran, which are active in this region.

Chinese leaders do not feel compelled to show progress in this or that year but instead work to advance Beijing's interests over decades or even longer. Others may seek to exploit that approach especially if they are interested in maintaining the *status quo* or oppose a resolution that would change it. But this vision gives China some real advantages because it means that Beijing's representatives can focus on their own pragmatic interests rather than on playing to the crowd and getting actively engaged in the disputes. And its promotion of these interests over the longer term means that China will support the maintenance of existing borders.

Beijing is clearly a reluctant new player in the complex geopolitical game in the South Caucasus, and could potentially become a partner of choice in this region, thus reducing traditional Russian control over the post-Soviet area.

The South Caucasus is but one region that is experiencing a growing Chinese presence. While this relationship has not yet reached the maturity of those enjoyed by Beijing's regional geopolitical contenders, it will increase in importance as China more effectively translates its interests into actions through expanded trade and investment. As part of this process, China's future engagement with the South Caucasus will increasingly rest on its pursuit of energy resources, trade and transportation corridors, posing serious challenges to the influence of traditional actors in the region.

Mehmet Ögütçü, Chairman, Global Resources Partnership (UK); Executive Chair, The Bosphorus Energy Club (Istanbul).

He is also an independent non-executive director on the board of Genel Energy PLC and a special envoy for The Energy Charter in Brussels for MENA/Eurasia
m.ogutcu@globalresourcepartnership.com

Endnotes

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- 2 <http://www.trade2cn.com/news/130419110212K7Q-1.html>
- 3 <http://old.cacianalyst.org/?q=node/5342>
- 4 https://www.gov.uk/government/.../China_in_the_South_Caucasus.doc
- 5 Again, in contrast to Kazakhstan and Turkmenistan, where Chinese energy companies are now established as serious rivals to their western counterparts for stakes in major upstream projects.
- 6 Source: DG Trade, European Commission.
- 7 http://www.silkroadstudies.org/new/docs/CEF/Quarterly/February_2007/Ismailzade.pdf
- 8 Currently estimated to number around 50 - 60,000 although the reliability of such figures is questionable.
- 9 http://etheses.lse.ac.uk/322/1/Gayoso_Russian%20hegemony%20in%20the%20CIS%20region.pdf
- 10 www.ceps.be/system/files/book/1855.pdf