



# RESEARCH BRIEF

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## Navigating Investments in Central Asia as Chinese Investors: A Case Study of Kyrgyzstan

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### Key Points:

- Although Central Asian countries such as Kyrgyzstan have promised to work with Chinese companies as they show growing interest in entering the region in light of the Belt and Road Initiative, considerable risks remain. Systemic political fragility and growing anti-China public sentiment in Kyrgyzstan pose considerable threats to investment success.
- Prospective Chinese investors can better navigate the non-business risks in the regulatory and social contexts through aligning their business objectives well with the incentives and needs of both the Kyrgyz government and local communities.

### Introduction

Since the inception of the China-led Belt and Road Initiative (BRI),<sup>1</sup> Central Asian states have seen a sharp increase in Chinese-funded local investments and projects. According to the Chinese Ministry of Commerce, in 2018, the volume of foreign direct investment in the five countries of Central Asia, Kazakhstan, Kyrgyzstan, Turkmenistan, Tajikistan and Uzbekistan, reached \$14.7 billion (representing 1.2% of all Chinese investment in Asian countries), a 40% increase from 2013 (\$8.9 billion).<sup>2</sup> This significant growth in business ties between China and Central Asia is accompanied by growing uncertainties and concerns among current and prospective Chinese investors over the local business climate and

<sup>1</sup> The Belt & Road Initiative, or “BRI”, is a China-led global infrastructure project first announced by Chinese President Xi Jinping during his visits to Central Asia and Southeast Asia in September and October of 2013. It runs through Asia, Europe and Africa, aiming to connect the East Asia economic circle at one end and the European economic circle at the other, and encompassing countries with huge potential for economic development. The Silk Road Economic Belt (SREB), primary focus of our brief, focuses on

tying China, Central Asia, Russia and Europe. *See generally Vision and Actions on Jointly Building Silk Road Economic Belt And 21st-Century Maritime Silk Road*, BELT AND ROAD PORTAL, <https://eng.yidaiyilu.gov.cn/qwyw/qwfb/1084.htm> (last visited Apr. 16, 2021).

<sup>2</sup> Temur Umarov, *China Looms Large in Central Asia*, CARNEGIE MOSCOW CENTER (Mar. 30, 2020), <https://carnegie.ru/commentary/81402>.

future investment security. Working in Kyrgyzstan, a country with 6 million people and plentiful natural resources such as minerals,<sup>3</sup> exemplifies many of the struggles and opportunities Chinese investors face at the forefront of BRI's westward expansion.

On one hand, the region's desperate need for critical infrastructure and reliance on foreign commodities and capital spurs Chinese investors to intensify their cooperation. One example of this cooperation is the Bishkek-Naryn-Torugart highway which Kyrgyz Minister of Transportation Bakyt Berdaliyev recently highlighted.<sup>4</sup> The highway in question runs from the nation's capital to the Chinese-Kyrgyz border north of the city and Special Economic Zone of Kashgar, and is seen as a success story for Chinese investment on the ground.<sup>5</sup> On the other hand, public backlash against Chinese investors over their business strategies and collusion with local governments has, in many cases, led to delayed operations and persistent loss, evidenced by the cancellation of a massive \$275million logistics center project in the mountainous, agrarian region of Naryn.<sup>6</sup> This project would have created up to 15,000 mostly local jobs and eased the transit of Chinese goods through the Eurasian Economic Union (EEU).<sup>7</sup> In

light of this "to be or not to be" tension, this Research Brief, zooms in on Kyrgyzstan as a case study and looks at the shared risk factors that Chinese investors should be cognizant of as they decide whether to enter the emerging, yet volatile, markets of Central Asia.

### The uneasy coexistence of risks and opportunities in Kyrgyzstan

Chinese investors are becoming increasingly well informed with regards to the strategic benefits of expanding into the Kyrgyz market, especially after the BRI was launched. Geopolitically, Kyrgyzstan today is both a member of the Russia-led Eurasian Economic Union (EEU)<sup>8</sup> and a signatory country to the China-led BRI and Asian Infrastructure and Investment Bank (AIIB). Chinese manufacturers have viewed Kyrgyzstan as the natural bridge connecting their domestic supply chains with downstream distribution channels, and Kyrgyzstan's economic under-development relative to its neighbors like Kazakhstan, has made the country an attractive target for cross-border expansion. For its part, Kyrgyzstan has continuously reassured the Chinese government and companies that it remains cooperative and diligent towards fostering a better business future.<sup>9</sup> According to the World Bank, "Moving

<sup>3</sup> *The World Factbook-Kyrgyzstan*, CIA.GOV (last updated Apr. 7, 2021), <https://www.cia.gov/the-world-factbook/countries/kyrgyzstan/#people-and-society>.

<sup>4</sup> *Kyrgyzstan pleads for more Chinese help in building key infrastructure*, EURASIANET (Dec. 9, 2020), <https://eurasianet.org/kyrgyzstan-pleads-for-more-chinese-help-in-building-key-infrastructure>

<sup>5</sup> *Id.*

<sup>6</sup> Dirk van der Kley, *China diversifies in Central Asia*, EURASIANET (Nov. 20, 2020), <https://eurasianet.org/china-diversifies-in-central-asia>. See also *China-led \$280 million Kyrgyzstan project abandoned after protests*, REUTERS (Feb. 18, 2020), <https://www.reuters.com/article/us-kyrgyzstan-china-investment-protests/china-led-280-million-kyrgyzstan-project-abandoned-after-protests-idUSKBN20C1HA> (reporting that the joint venture

responsible for the construction decided to pull out due to anti-China public sentiment and local community opposition).

<sup>7</sup> *Id.*

<sup>8</sup> Kyrgyzstan formally joined the Eurasian Economic Union in 2015. This move allowed the country broader access to EEU markets and better labor mobility between EEU member nations. See Catherine Putz, *Kyrgyzstan (Finally) Joins the Eurasian Economic Union*, THE DIPLOMAT (May. 22, 2015), <https://thediplomat.com/2015/05/kyrgyzstan-finally-joins-the-eurasian-economic-union/>.

<sup>9</sup> See Chris Rickleton, *Kyrgyzstan: Authorities wake up to business climate blues*, EURASIANET (Feb. 19, 2020), <https://eurasianet.org/kyrgyzstan-authorities-wake-up-to-business-climate-blues> (reporting that Kyrgyzstan's President Sooronbai Jeenbekov pledged "A paradise for

toward international good practices such as open and transparent public procurement would increase the likelihood that BRI projects are allocated to the firms best placed to implement them.”<sup>10</sup> As applied to investment in Kyrgyzstan, the World Bank’s recommendation means that the Chinese firms that operate with higher efficiency, better synergies and cost margins are more likely to obtain BRI projects. Despite Kyrgyzstan’s promise to work with Chinese companies as they show growing interest in entering the country, considerable risks remain. To provide better clarity as prospective Chinese investors navigate their investment decisions in the region, I will elaborate on the regulatory and social factors that should inform major business considerations.

**Systemic political fragility and growing anti-China public sentiment blur investment success**

Kyrgyzstan has seen waves of social upheaval as it strives for a more representative and democratic government. As recently as October 2020, civil grievances over an economic downturn and fraudulent parliamentary elections as a result of vote-buying and voter intimidation acts, resulted in social unrest and a nationwide state of emergency.<sup>11</sup> Fights over political power had, in the past, contributed to Color Revolutions in both 2005 and 2010. In both cases, corruption,

repressive politics, and over-concentration of power were among the major drivers behind the large-scale revolt and instability.<sup>12</sup> Unrest in Kyrgyzstan has followed the same pattern: the former president and his administration, who had been suppressed by the incumbent president and his inner-circle, took advantage of ongoing civil disobedience, inter-factional differences and ethnic conflict and seized the opportunity to position themselves as the cure for the nation’s various problems. This volatile political landscape has disrupted the consistency and predictability of Kyrgyzstan’s regulatory and policy-making spheres. While Chinese businesspeople are accustomed to strategizing in business terms, they tend to overlook the non-business contexts shaping their particular organization, thus making operational plans and decisions on the basis of biased assumptions.

Causes of the insurgencies discussed above are deeply rooted in the Kyrgyz society, history and culture; as such, it is implausible for an outsider-newcomer to fully comprehend all of the relevant dynamics. To make matters worse, during times of crisis, Kyrgyz officials have not intervened in a timely manner to protect Chinese-owned businesses and essentially acquiesced to vandalism committed by local activists. For

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business” when he was sworn into office in 2017); *see also supra* note 4 (quoting Nurlan Suerkulov, director of Kyrgyz Foreign Ministry’s external communications service, on saying that “China is and always will be a priority partner in Kyrgyzstan’s foreign policy. As a true friend and a reliable partner to Kyrgyzstan since the establishment of diplomatic relations, [China] has provided and continues to provide significant assistance in the most difficult times”).

<sup>10</sup> WORLD BANK, BELT AND ROAD ECONOMICS: OPPORTUNITIES AND RISKS OF TRANSPORT CORRIDORS (June 19, 2019), <https://www.worldbank.org/en/topic/regional-integration/publication/belt-and-road-economics-opportunities-and-risks-of-transport-corridors> (explaining

an independent analysis of the risks and opportunities of Belt and Road transport corridors).

<sup>11</sup> Gavin Helf, *In Kyrgyzstan, It’s Easier to Start a Revolution than to Finish It*. UNITED STATES INSTITUTE OF PEACE (Oct 8, 2020), <https://www.usip.org/publications/2020/10/kyrgyzstan-its-easier-start-revolution-finish-it>. *See also* *Kyrgyzstan unrest: Ex-president rearrested as power struggle deepens*. BBC NEWS (Oct 10, 2020), <https://www.bbc.com/news/world-asia-54493185> (“...President Jeenbekov has said he will resign when a new government is formed and the rule of law is restored... Demonstrators cannot agree on who should lead the new government. Each group wants their own leader to take power...”).

<sup>12</sup> *Id.*

instance, at the start of the unrest last year, 35 Chinese executives fled to a hotel in Bishkek, only to be surrounded by an armed mob seeking ransom.<sup>13</sup> Over 100 Chinese workers spent the night of October 6, 2020 in a snowy forest after fleeing a mob that had occupied their mine.<sup>14</sup> Although financial damage done during these turbulent times could be repaired, the loss of trust and investment confidence endures and has a ripple effect on business-owners and Chinese employees.

Because Kyrgyz officials “don’t care” enough to protect Chinese investors,<sup>15</sup> many Chinese investors have no choice but to turn to bribing government officials for protection. However, given the country’s complicated political climate, interestingly, investors would often times be better served if they choose not to bribe as doing so could align them with the “wrong side.” Needless to say, proper state protections of foreign investors, in particular their safety and asset security, is a key step in retaining them, but protections are more easily promised than administered. When legitimate rights and interests of Chinese citizens and enterprises in Kyrgyzstan could be targeted with violence, business executives, however risk-tolerant, are unlikely to remain in-country and contribute to long-term growth and expansion. Too exercised about their personal political future, sitting officials are not sufficiently mobilized to fulfill their commitment to safeguarding the success of Chinese-owned businesses.

In the worst-case scenario, a business could get entangled in political fights inside the country. Recently, the Kyrgyz government investigated a scandal where officials allegedly awarded a contract to refurbish Bishkek Thermal Power Station to Tebian Electric Apparatus, a Chinese company active across Central Asia, without proceeding with a proper tendering process.<sup>16</sup> This decision was scrutinized after a power outage left thousands of people without heat for days when temperatures neared minus 30 degrees Celsius.<sup>17</sup> In one other case, it was reported that officials associated with then Prime Minister Sapar Isakov (2017-2018) colluded with the contractor, the China Road and Bridge Corporation, in grossly inflating construction costs, upon the receipt of \$850 million loan from the Export-Import Bank of China for the Bishkek-Osh motorway.<sup>18</sup> Such incidents inevitably prompt public debates about Chinese cultural and humanitarian influence in the country as a result of the growing business presence.

Moreover, it is foreseeable that nations heavily reliant on foreign investment such as Kyrgyzstan could behave strategically in response to evolving international power dynamics. Although focused on attracting Chinese money and business opportunities, Kyrgyzstan has also been working closely with Russia on promoting regional free trade in the realm of the EEU and with the United States in regards to furthering economic cooperation within the scope of the C5+1

<sup>13</sup> Niva Yau, *China business briefing: Not happy with Kyrgyzstan*, EURASIANET (Nov. 3, 2020), <https://eurasianet.org/china-business-briefing-not-happy-with-kyrgyzstan>

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> Altynai Mambetova & James Kilner, *Kyrgyzstan grows wary of China amid corruption probe*, NIKKEI ASIA (July. 4,

2018), <https://asia.nikkei.com/Politics/International-relations/Kyrgyzstan-grows-wary-of-China-amid-corruption-probe>.

<sup>17</sup> *Id.*

<sup>18</sup> Stefan Hedlund, *China finds investment in Kyrgyzstan a risky necessity*, GEOPOLITICAL INTELLIGENCE SERVICES (Apr. 11, 2019), <https://www.gisreportsonline.com/china-finds-investment-in-kyrgyzstan-a-risky-necessity.economy.2843.html>

framework.<sup>19</sup> The multidimensional nature of Kyrgyz foreign relations and ongoing competition between global powers in the area can cast doubt on the country's future willingness to sustain the present economic connectivity with China. After all, more than 7 years since the BRI came into being, Central Asian economies have suffered from many detrimental consequences as a result of welcoming BRI with open arms - the disruption of construction, the displacement of public trust, the destruction of the local environment.<sup>20</sup>

Therefore, not only should Chinese investors build a basic understanding of Kyrgyz domestic policy environment, but also shall they keep abreast of the foreign policy changes in the greater geopolitical context of Central Asia and Eurasia and the implications for their businesses.

In regards to the question of Chinese business impact on the local society and community, Chinese investors have historically overlooked the importance of corporate social responsibility. Kyrgyz citizens have increasingly voiced their concerns and protested the collusion of their national government with Chinese businesses.<sup>21</sup> A win-win situation between the company-investor and the local community is most sustainable if a company sees fostering harmony with the local community as being in its long-term business

interest. Public hostility against one Chinese investor would only harm the image of all and can be exploited by the government in seeking more corruption activities. The time when new businesses were received with enthusiastic support from citizens and from levels of government has passed, so prospective investors need to be prepared to deal with widespread anxiety among the locals.

Kyrgyzstan still has a lot to gain by engaging in the BRI, from infrastructure upgrades to new job creation, from digitization to access to capital. However, the fact that the Kyrgyz government is welcoming more Chinese investment, as signaled by more signed bilateral agreements and more appearances of Kyrgyz leaders at China-hosted forums, does not always reflect current public opinion. If much of the policy-making process lacks transparency and public input, then an incoming Chinese company must do its own research on how its operations would be perceived by the local public. For instance, a Chinese company, Shenzhen Sunwin Intelligent, was working on the second stage of Kyrgyzstan's Safe City project, which entails the installation of new cameras both in the capital city of Bishkek and across the entire country.<sup>22</sup> Although the Kyrgyz government supported the

<sup>19</sup> For more on the U.S. position with respect to Central Asia, see *United States Strategy for Central Asia 2019-2025: Advancing Sovereignty and Economic Prosperity (Overview)*, U.S. DEPARTMENT OF STATE (Feb. 5, 2020), <https://www.state.gov/united-states-strategy-for-central-asia-2019-2025-advancing-sovereignty-and-economic-prosperity/> (explaining policy objectives the United States has outlined for the coming years on Central Asian development)

<sup>20</sup> Wade Shepard, *Another Belt And Road Project Bites The Dust As China's New Silk Road Continues To Struggle*, FORBES (Feb. 25, 2020), <https://www.forbes.com/sites/wadeshepard/2020/02/25/another-belt-and-road-project-bites-the-dust-as-chinas-new-silk-road-continues-to-struggle/?sh=20eb96c653e3>

<sup>21</sup> *Supra* note 14. See also Agata Palickova & Georgi Gotev, *Scandals in Kyrgyzstan highlight dubious Chinese business practices*, EURACTIVE (July. 23, 2019), <https://www.euractiv.com/section/central-asia/news/scandals-in-kyrgyzstan-highlight-dubious-chinese-business-practices/> (reporting that this scandal has led to the arrest of two Kyrgyz former prime ministers, Sapar Isakov and Jantoro Satybaldiev for improperly handling the \$386 million contract); REUTERS, *supra* note 5 (reporting that in 2019 hundreds of local Kyrgyzs clashed with workers of a Chinese mining company in the Naryn province - the same region where the abandoned logistics project was located after accusing the miner of poisoning local water supply).

<sup>22</sup> Temur Umarov, *supra* note 2.

implementation of this social credit system, which “reward[s] citizens for good behavior and punish[es] them for misdemeanors”, the public attitude towards such extensive use of surveillance camera networks remains unclear.<sup>23</sup>

### Implications for navigating non-business risks

So, what can investors do to hedge their risks? The short answer is to do the homework and that due diligence does matter. Any Chinese businessowner has to ensure his or her business objectives align well with the incentives and needs of both the Kyrgyz government and local communities. The shift in narrative around Chinese business influence is alarming, so rather than treating these non-business risks merely as costs of doing business, Chinese investors should proactively reach out to the local communities. It was reported that in some instances, local Kyrgyz communities had never interacted with nearby Chinese businesses, and public perception was based on “stereotypical assumptions, clichés and fear.”<sup>24</sup> “They were more open to welcoming Russian, European, or Central Asian investors, and were rather cautious about Chinese businesspeople.”<sup>25</sup> Despite their caution, local Kyrgyz citizens acknowledged that Chinese-built infrastructure has changed their lives for the better and that Chinese companies are more credible and reliable than local counterparts.<sup>26</sup> Political intervention also plays a part in the campaign to manage public relations and reshape local perceptions, and Chinese embassies and

consulates can be actively involved in mediating disputes between Chinese enterprises and local partners in high-risk regions.<sup>27</sup> While a “pick and choose between nations” coupled with a “wait and see” approach would work in the short term, privately-funded projects may not withstand the impacts of periods of insolvency in turbulent times.

The use of Kyrgyzstan as the subject for this study is not to suggest that the investment environment is similar across Central Asian nations, nor it is to imply that investors should treat them alike. The rationale is simply to pinpoint what these nations may share in common in their treatment of Chinese businessowners. Certainly, the anti-Chinese sentiment in the business sphere is not unique to Kyrgyzstan.<sup>28</sup>

Kyrgyzstan’s case demonstrates the uneasy co-existence of risks and opportunities for Chinese investors in Central Asia. Investments are expected to generate returns, and Chinese investors, the Central Asian countries and local communities should all gain, not lose, from this engagement. Future research is warranted to examine the salient differences across the five Central Asian states and the industry-level implications for Chinese business owners.

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<sup>23</sup> *Id.*

<sup>24</sup> Kemel Toktomushev, *Anti-Chinese Sentiments in the Extractive Industry: A Central Asian Example*, CHINA-US FOCUS (Jan. 22, 2021), <https://www.chinausfocus.com/foreign-policy/anti-chinese-sentiments-in-the-extractive-industry-a-central-asian-example>

<sup>25</sup> *Id.*

<sup>26</sup> Ashok Sajjanhar, *China-Central Asia relations: An uneasy co-existence*, OBSERVER RESEARCH FOUNDATION (Mar. 10, 2021),

<https://www.orfonline.org/expert-speak/china-central-asia-relations-an-uneasy-co-existence/>.

<sup>27</sup> Matthew S. Erie, *Chinese Law and Development*, 62(1) HARV. INT’L L. J.).

<sup>28</sup> Wade Shepart, *supra* note 20 (listing causes of protests against China in Kazakhstan as construction of new Chinese factories and power plants, the prospect of Chinese investors transacting land, and the perceived environmental damage from China moving in low-grade industry).

