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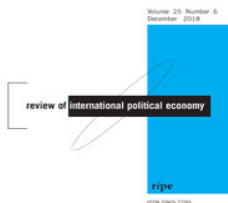
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# The dual transformation in development finance: western multilateral development banks and China in post-Soviet energy

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## ABSTRACT

The energy resources of Central Asia and the Caucasus have drawn significant scholarly attention due to their geopolitical importance and role in regional economic development. Western multilateral development banks (MDBs), such as the World Bank and the EBRD, have been the leading actors shaping norms and practices for lending to the energy sectors of these regions. China has also recently emerged as the top investor in hydrocarbons and renewables in Central Asia, at the same time increasing its presence in the Caucasus. How have Western MDBs and China shaped each other's lending practices? By exploring the *what* and the *how* of development finance in the energy sectors of Central Asia and the Caucasus, this study argues that *a dual transformation* is under way. The World Bank and the EBRD are now working closely with key local stakeholders in the recipient states to make energy reforms more successful. China, on the other hand, is now cooperating more closely with Western MDBs, and accepting and implementing some of their market principles and environmental targets. The article demonstrates that the West vs. China dichotomy based on neoliberalism vs. state-capitalism is blurred and the post-Soviet energy sector includes features of both models.

## KEYWORDS

Energy; development finance; World Bank; EBRD; China; dual transformation

## Introduction

Multilateral Development Banks (MDBs) provide non-concessional financial assistance to middle-income and creditworthy low-income countries on market-based terms. They also provide concessional assistance, including grants and loans at below-market interest rates, to low-income countries (Congressional Research Service (CRS), 2020). Globally, by sector, the largest investment needs lie in transport and energy infrastructure. For Asia alone, estimates by the Asian Development Bank (2017) point to investment needs of around USD 26 trillion until 2030, including the promotion of green energy and energy efficiency.

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Western MDB governance changes, however, have been slow to reflect China's ascendant role in the global economy. According to Lo (2016) and Owen (2020) the emergence of China-led MDBs is to be understood as Beijing's reaction to the imbalance of power across the existing framework of intergovernmental institutions, which favours Western countries despite their relative decline in global influence. The long-standing failure to give China a voting share in the IMF and the World Bank (WB) commensurate with the size of its economy has been a particular irritant, to which China has responded by pressing for a greater say in global economic governance and by creating its own multilateral mechanisms to pursue a resurgent regional development agenda. In relation to the former, Xi Jinping has repeatedly pledged to increase China's financial contributions to The WB and other regional development banks, signalling its continuing commitment to existing institutions. As regards the latter, it is investing far greater resources in the Asian Infrastructure Investment Bank (AIIB) and the Belt and Road Initiative (BRI) – a sprawling network that seeks to open up new trade routes, expand overseas opportunities for Chinese firms and deepen the country's strategic influence through the financing and building of infrastructure (Calder, 2019; Rolland, 2017).

Numerous Beijing-controlled institutions are involved in BRI, though in varying degrees. They include policy banks, such as the Export-Import Bank of China (Exim Bank) and the China Development Bank (CDB) (Gallagher et al., 2018); state-owned banks, including the China Construction Bank and the Agricultural Bank of China; state-owned funds, such as the Silk Road Fund; and China-led MDBs, such as the AIIB and the New Development Bank (Chin & Gallagher, 2019). Critics lament China's closed-door, state-led bilateral negotiations with creditor countries and lending done at commercial rates secured with a country's natural resources (Spengle & Isaac, 2020), which is considered to put Beijing at a major advantage over borrowers when loans are being created, an advantage that persists during any renegotiation (Parkinson et al., 2020). China, meanwhile, declares itself to be committed to a multilateral approach to investment including MDBs and private-public partnerships (OECD, 2018). Beijing has also denied engaging in what critics call 'debt-trap diplomacy' (Xi, 2017, p. 5). Criticism from the U.S. – the most vocal among its detractors – comes against the backdrop of an intensifying rivalry between the world's two biggest economies, which the Covid-19 crisis has only served to inflame.

The growing divide between Western MDBs' development finance versus the sprawling influence of China's state-centric approach belies, however, a process of mutual learning and emulation uncovered in this paper. This article focuses on Central Asia and the Caucasus for several reasons. First and foremost, the literature on Western-led and Chinese development finance has extensively covered other regions of the world including Latin America (Bräutigam & Gallagher, 2014), Africa (Bräutigam & Gallagher, 2014; Dreher et al., 2018) and Southeast Asia (Camba, 2021; Katada & Liao, 2020; Liao, 2019). The post-Soviet space in general, and Central Asia and the Caucasus in particular, have so far remained undiscovered territory in the literature on development finance despite the growing attention paid by Western MDBs as well as the intensification of the Chinese role in these regions. The most important development financing initiatives to have emerged in Central Asia and the Caucasus have come out of the energy sector, which is the most lucrative branch of these countries' economies and by far the

largest sector for which loans are offered both by Western MDBs and China. As of 2020, the WB's energy lending has reached approximately \$4.4 billion in Central Asia and \$2.9 billion in the Caucasus. On the other hand, the combined lending by the CDB and the Chinese Exim Bank in Central Asia have surpassed \$17 billion (see [Supplementary material](#), Appendix).

Western MDBs and the Asian Development Bank (ADB) have multiple targets in the development of Eurasian energy governance. First, they offer lending for the extraction and modernization of delivery infrastructure for hydrocarbons, thereby contributing to energy security of both the region itself and Europe. Second, they support the transition of local economies away from overreliance on hydrocarbons. Third, they help spur practices of good governance in the energy sector. These targets are consistent with the overall lending strategy of MDBs across the world (on the WB see Güven, 2017, p. 502; Heldt & Schmidtke, 2019). Thus, Eurasia can offer important empirical and theoretical insights on the convergence of Western and Chinese-led development finance practices and enrich IPE's focus on transformative change in the energy sector. Existing literature on the engagement of MBDs in Central Asia and the Caucasus, however, is surprisingly scant. Existing reports (Asian Development Bank, 2016; EBRD, 2018) highlight that Central Asia and the Caucasus, along with North, West and East Africa are the regions with the largest number of banks operating, while the Pacific stands out as having very few (Prizzon & Engen, 2018, p. 15). While a rise in 'green' financing across post-Soviet Eurasia is largely recognised, little effort has been made to grasp empirically the evolving nature of lending practices of both Western and Chinese development finance actors in the region.

The paper aims to contribute to diverse bodies of literature by systematically exploring the *what* and *how* of existing development finance actors in the region. By moving beyond the 'what' and examining the 'how', it seeks to understand the prevailing circumstances giving rise to the implementation of specific projects. We begin the analysis with an overview of the salient literature on Western and China-sponsored development finance institutions in Central Asia and the Caucasus. We then examine the characteristics of Western MDBs' and China's lending across Central Asia and the Caucasus to help spur development. We focus on the nature of the projects in the energy sector and how Western MDBs have attempted to achieve their objectives by focusing on neoliberal ideas such as market liberalization and competition as well as climate targets. China has displayed a strong preference for bilateral diplomacy: it primarily offered commercial loans in U.S. dollars to host governments from Beijing-controlled institutions, along with selected strategies to exert geopolitical power and secure vast hydrocarbon resources in post-Soviet Eurasia and elsewhere. However, both Western and China-led development finance strategies have in the past two decades become more nuanced. This evolution in their approaches has resulted in China's greater disposition toward multilateralism, recognizing that this may complement and assist its bilateral objectives. While bilateralism continues to be the dominant mode of Chinese development finance, Beijing increasingly promotes multilateralism and cooperation with MDBs, as stated in the most recent official document titled 'China's International Cooperation in the New Era' (The State Council, 2021). In the last decade, Chinese or China-led lenders have worked more closely with Western MDBs with an implicit acceptance of some of the market principles and climate targets promoted by

Western banks and the ADB. In turn, Western MDBs have made local governments – and their informal networks – more invested in the prescribed reform efforts, thereby pursuing a strategy of ‘joint ownership’ of reform agendas and emulating some of China’s economic statecraft strategies and policies. This has resulted in a process whereby growing competition and interaction between Western and China-led development finance practices has spurred a *dual transformation*.

The empirical sections that follow show that three types of interaction – cooperation, emulation, and diversion – take place in Central Asia and the Caucasus. To demonstrate the impact of this dual transformation, we rely on primary sources such as the WB’s Country Partnership Frameworks and the EBRD’s Country Strategy documents. We also refer to an original self-compiled dataset that includes all the projects in which the WB, the EBRD and the Chinese development finance institutions have offered loans in the energy sectors of the countries in Central Asia and the Caucasus. Finally, we make use of semi-structured interviews on the impact of China’s rise and the emergence of development finance rivalry between the West and China in these two regions. The final section concludes and discusses the broader implications of our findings. Establishing the material position of development finance institutions in Eurasia is straightforward. We have gathered economic data on Western MDBs and China’s integration in Central Asia and the Caucasus. Explaining the causal relationship between individuals, informal networks, and institutions at the local level, on the one hand, and lending policies, on the other, is more challenging, but is grounded in the considerable empirical evidence collected. Establishing that this approach amounts to a mutual learning is much harder. To establish whether convergence and transformation were motivated by mutual learning, we examine a variety of documentary sources. This requires process-tracing of decision-making in specific instances to see *how* and *why* certain policies were adopted and what the motivations behind them were. It is necessary to show that lending actors were motivated by or framed their lending decisions in terms of the lending practices and strategies adopted by rival institutions. The argument advanced in this article is not that this ‘dual transformation’ always shapes Western MDBs’ and Chinese development financing on every issue, but rather that such processes are key in explaining why the stakes of global governance in other arenas may (and probably are) going to be characterized by more interaction and convergence than contestation and divergence.

## **Explanations for the role of Western and Chinese development finance in Eurasia**

In Central Asia and the Caucasus, MDBs primarily fund large energy infrastructure and provide loans tied to policy reforms by the government (OECD, 2018). As Nakhooda (2011) notes, climate change has become a growing priority for MDBs, but the countries of the region continue to prioritise investment in hydrocarbons’ extraction and transmission technology. In the last two decades, we have also witnessed a growing Chinese economic presence in Central Asia, in lockstep with its growing energy demand (Skalamera, 2018). China’s ballooning investments in Central Asian energy sector (which span over 50 projects with a total of \$67 billion; see [Supplementary material](#), Appendix) increasingly emphasise (i)

development issues over geopolitics as a means of reaching China's regional priorities in Eurasia and (ii) how China's investment in 'greening' within the region must be viewed in light of its long-term effort to curb pollution and set itself at the forefront of clean technology investment at home and abroad. China's key lending and investment arms have included state-owned corporations such as the CNPC, and the two leading policy banks – Exim Bank and CDB. More recently, Chinese private firms have increasingly inserted themselves in the renewables market in the region. For instance, the Kazakh government, which has a \$9bn stimulus plan directing money from its sovereign wealth fund to infrastructure investment, has increasingly supplanted German solar panels in the Zhambyl region with Chinese ones as a cost-benefit analysis now favours the Chinese equipment.<sup>1</sup>

In the literature on resource-based economies, China's rapid development of pathways for both trade and influence across Eurasia has stimulated particular interest (Amineh & van Driel, 2018; van der Kley, 2020). Yet there is little evidence on the linkages between China's exponential growth in energy investment and the policy repercussions for the activities of existing MDBs in that very same region. China's interest has complemented, but also competed with, the efforts of Western MDBs, themselves actively engaged with most Eurasian countries on energy infrastructure development and related governance issues. China's rapidly growing interest in infrastructure funding in the region, often tied to its own construction companies, has not meshed well with the environmental, social, fiduciary, and procurement safeguards of Western MDBs (Lee, 2017). In response, China has ramped up its own bilateral development programs and led efforts to 'play by its own rules' by creating two new development banks: AIIB and the New Development Bank (NDB) (Vazquez & Chin, 2019). Less appreciated, however, is how over the last decade Chinese energy development finance has emulated the standards, organizational forms, and even the demands for safeguards of Western MDBs. As this paper will show, the mimicry varies depending on the institution, but the common denominator is a desire to portray China as a good regional and global citizen.

Conversely, according to the extant scholarship, Western MDBs have influenced Eurasian energy governance in two ways. First, engagement in the energy sector focused on supporting market-oriented reforms emphasizing openness, competition and marketization over state control of energy (Öge, 2015). As in other regions of the global economy, the WB, the EBRD, and the ADB have focused on the wisdom of markets and the limited role of the state, including fiscal discipline, cutting subsidies, trade liberalization, privatization, and deregulation (Heldt & Schmidtke, 2019, p. 1169). In contrast, most of the Chinese funding in the energy sector across Eurasia comes from state-directed development and national banks, along with the formation of new state-led vehicles to help with the financing, such as the Silk Road Fund (Owen, 2020). Second, and relatedly, Western MDBs have exerted influence through their financing, but also through their support for new *norms* and *ideas*. The WB and the ADB have been highly influential actors in global energy governance, spreading a cluster of neoliberal ideas centred around technology, regulation, transparency, and policy service delivery as they invested in new energy infrastructure around the developing world (Öge, 2017). They have not always effectively reconciled competing environmental, social, economic and geopolitical dimensions of energy governance, however. More recently, with Beijing

expanding pathways for influence across Eurasia, this neoliberal paradigm has found competition from an increasingly state-centric version of Chinese capitalism.

The literature on the contradictory nature of Western vs. Chinese development finance is by no means limited to Eurasia. Since Naim's (2007) characterization of China's development assistance as 'rogue aid', a rich body of literature has examined China's lending practices in different regions of the global economy. The lack of transparency, poor attention to environmental and social safeguards (Dollar, 2018; Gallagher et al., 2018) and the use of indebting weaker neighbours to gain leverage over them and pursue strategic aims in the lending practices of China's state-owned policy banks such as CDB and Exim Bank have been met by concern (Bräutigam, 2011; Bräutigam & Gallagher, 2014; Dreher et al., 2018, p. 189).

Others, on the other hand, have examined the process of convergence between the lending agendas, norms, and practices of Western development finance actors (primarily the WB), Japan and China. Chin (2012, p. 215) argues that through a 'two-way socialization' China no longer only internalizes the norms of the WB, but also 'shapes the norms, rules, and principles of international institutions'. Similarly, Katada & Liao (2020) find that a 'development norm convergence' is under way, as China learned from and emulated Japan's development policy norms and practices, while Japan responded by transforming its own infrastructure lending in Asia. It has been argued that AIIB, in particular, is taking a hybrid layered approach in pursuit of innovation and a more transformative agenda to generate positive developmental spillovers (Vazquez & Chin, 2019). In that respect, some scholars have emphasized that China as a provider of development finance is changing the *type* of development that traditional donors support. For example, Zeitz (2021) finds that the WB responds to competitive pressure from China by emulating the Chinese emphasis on infrastructure-intensive sectors.

We build on this literature by integrating it with a dynamic, political economy approach. The governance of the energy sector and development finance in Eurasia is often presented as a contest between a Western and a Chinese approach. But, as we unearth below, Western MBDs and China's development finance institutions have found ways to work together in shaping the energy governance of Central Asia and the Caucasus in a dynamic process of learning and convergence including the areas of green financing, efficiency, diversification and climate change investment. The evolution in their approaches has resulted in a *dual transformation*: we no longer observe a binary competition between Western neoliberalism and Chinese state capitalism. In the following sections, we develop this argument as an alternative to prevalent perspectives.

## **Western and China-led development finance in Eurasia: a dual transformation**

The above body of work has provided a powerful foundation for understanding the logic by which both Western and Chinese development finance can change over time, thereby producing subtle shifts in the behavior of said lending institutions. Yet perhaps because the logic of emulation seemed sufficient to explain how lender strategies evolve, scholars have done little to account for the actual *process* by which emulation is happening. We introduce the concept of 'dual transformation'



to explain the *process* by which both Western and Chinese development finance evolved through convergence and mutual learning.

An alternative account of Western and Chinese *dual transformation* focuses not on the usual dichotomies between Western vs Chinese project financing but instead on the nature of the particular lender-recipient country interactions. Rather than stressing horizontal comparisons in power relations and tactics among Chinese and Western development finance institutions, this framework stresses the multi-level lender-recipient country relations as the structuring factor behind the dual transformation. This alternative account agrees with existing works about the impetus behind Western MDBs' and Chinese emulation and change, but it departs from those accounts by specifying a different *causal mechanism* of how dual transformation occurs. Dual transformation describes relations between Western MDBs and China's development finance institutions in reference to (1) the *levels* at which they are learning, imitating, and coordinating with each other and (2) the *types* of interaction that they are advancing in recipient countries across Eurasia.

First, we suggest that Western and Chinese development finance in Eurasia should be reframed as occurring at two levels: the national level and the informal level. Second, we identify three *types* of interactions between Western and Chinese development finance actors which are, in turn, exemplified by their interaction with the local authorities: (1) *cooperation* between Western MDBs and China on the financial activities. Western MDBs and Chinese lending institutions have cooperated in important ways and at high levels. As noted by an ADB country director, Chinese and Western MDBs bolstered their staff and information sharing through donors' conferences, while ADB allowed AIIB to use its regional offices in Central Asia.<sup>2</sup> Initially, cooperation on hydrocarbon and infrastructure-focused projects was privileged, but this type of collaboration laid the groundwork for greater convergence and trust in other more complicated areas, such as joint projects in renewable energy; (2) *emulation* – as some have noted but is frequently underappreciated – we demonstrate that Western and Chinese lenders emulated each other's tactics, organizational forms, and even the types of domestic political interactions that they decided to cultivate 'on the ground' in recipient countries. For example, given that revenue from energy sources in Central Asia and the Caucasus typically provides an important livelihood for the state and a tiny elite within it, not unlike their Chinese counterparts, Western MDBs have moved away from conditionalities, focusing instead on using national governments and informal local elites; (3) *diversion* – finally, Western and Chinese development finance actor interactions at the above-mentioned levels forced them to reconsider and even change their own modes of engagement in the region. While Western MDBs have sought conditionalities, there is now a joint ownership between the host country governments and the MDBs. While the Chinese have been more bilateral and focused on fossil fuels, there is recognition of multilateralism today and the prioritization of green projects.

Given the constraints that China's energy mercantilism (Lind & Press, 2018; Zhao, 2008) places on the development of the new market initiatives (Zhang & Andrews-Speed, 2020), Beijing has in recent years been more receptive to lessons from the liberal West: energy vulnerability and rampant air pollution have led China to support green financing initiatives and to launch cooperation with rival energy consuming nations through participation in multilateral financing

organizations and other forums (Ziegler, 2006). In Central Asia and the Caucasus, China's state-led development banks and the AIIB work alongside Western MDBs as well as Korean and Japanese development finance actors in the development of hydrocarbon projects and, increasingly, to promote green technology, renewable energy projects and other low-carbon development.

At the same time, Western MDBs active in the post-Soviet energy governance – such as the WB and the EBRD – have been criticised for foisting neoliberalism that disproportionally benefits Western stakeholders on to peripheral Eurasian states (Burns et al., 2017). Shields (2020) argues that each post-communist shift advised by EBRD has been an attempt at reinvigorating neoliberalism with a recurrent tendency to repeat the same mistakes even in the face of policy failures; a cycle that Abdelal (2020) has described as 'learning and forgetting'. It is well-known that there has been a gradual transformation in terms of *what* Western MDBs invest in; they are now increasingly supporting climate change mitigation efforts. However, little is known about whether there has been any verifiable transformation in *how* they invest, i.e. whether there has been a change in their neoliberal economic orthodoxy and, if so, how this has influenced policy practices vis-à-vis recipient countries in post-Soviet space. Just as China's role in state-led financing has evolved toward more market-oriented practices, this study traces how, amid China's competition in hydrocarbon and clean technology investment, the Western MDBs' strategy in Eurasia, too, has evolved. It has shifted from advocating a restructuring intended to promote a 'neoliberal' political consensus (i.e. privatization and deregulation from above to gain approval for investments benefiting Western corporations in the economic space of the region) to backing 'joint ownership' of reforms within the institutions of the Caucasus and Central Asia. Western MDBs now acknowledge the limitations of intrusive political conditionality, as local actors have become experts in 'norm localization', borrowing neoliberal ideas and fitting them into indigenous traditions and practices (Cooley, 2012, p. 9) – a process that has strongly conditioned the implementation of Western MDBs' reform agenda.

Instead of pressing unequivocally for a leaner state, Western MDBs have implicitly acknowledged that greater state involvement in the economy is a trend to be reckoned with across Eurasia and elsewhere (EBRD, 2020b), and have consequently adjusted their approach. The new policies emphasise the value of 'joint ownership' of the reform agenda and, most importantly, the recipient governments' strong financial and personal commitment to reforms at the highest ranks of the executive (EBRD, 2017). This recognition that 'the state is here to stay', and that key to actually delivering structural reform is the ability to forge cooperation with the actors 'calling the shots' in the recipient states, represents a clear departure from the neoliberal recipes for development finance that reached their peak with the Washington Consensus and centred on stringent demands for safeguards and conditionality (Heldt & Schmidtke, 2019, p. 1179).

We therefore highlight the inherent connection between Western MDBs' efforts to promote good energy governance and the shift in their strategy: they are now interested in working with key stakeholders in the governments of recipient countries to promote structural reforms geared toward protection of individual rights in the energy sector, especially with respect to private property and investment contract enforcement. Such shifts in policy and strategy are historically contingent and

must be understood contextually; the global financial crisis has not only damaged the credibility of the Bretton Woods institutions but, along with the rise of China, has opened up new opportunities for those who would challenge Western-made rules (Fioretos & Heldt, 2019; Lo, 2015, p. 46). In light of these developments, smaller states and regional actors in Eurasia have pushed back against Western universalism, guarding and supporting their own domestic practices and vested interests concentrated in the energy sector, thus demonstrating that they are no longer passive objects of great power diplomacy but increasingly sovereign actors (Bitabarova, 2018). Western MDBs have for the most part been forced to recognise their diminished capacity to influence their behaviour. Their evolved consultative style in development finance is a pragmatic response that acknowledges the need for accommodation in the absence of a viable alternative.

The gradual evolution in Western MDBs' regional development agenda resembles O'Neill's (2014) characterization of China's evolving role in the Kazakh energy sector; O'Neill's study details how the Chinese government's strategy has evolved from one of simply buying off key members of the Kazakh government in order to gain approval for investments to one of making institutions in the Kazakh state, such as state-owned energy company KazMunaiGas, stakeholders in the long-term success of the investment in order to secure protection for investments in a climate of political uncertainty. Such rulemaking is employed in a selective manner and makes individual actors within the recipient institutions materially committed to reform. Efforts to engage more closely with the recipient governments in the promotion of energy reform, capacity building, and good governance are one instance where Western MDBs' evolving strategy in Central Asia and the Caucasus resembles the work done by China in the last two decades.

The dual transformation we observe does not correspond to the common distinction between Western MDBs' neoliberalism and China's state capitalism in providing development finance to the region; instead, we argue that both systems involve neoliberal and statist aspects. China has sought to develop new market initiatives and embrace the practices and ideas espoused by Western MDBs (Zhang & Andrews-Speed, 2020; Ziegler, 2006), while the latter's turn to a more prudent bottom-up strategy of institution-building mixed with making local stakeholders more invested in the reform effort means that a rigid juxtaposition between Western neoliberalism and China's state capitalism in the region no longer holds; both logics operate at the same time, reproducing dualism at all levels and allowing lenders to prioritise elements of either according to the inherent internal priorities of decision-makers and the dominant narratives within both.

### ***How state-led and informal network policies matter in Eurasia***

Although Western and Chinese development finance practices have affected many regions of the world, they have not done so evenly. Some parts of the world have spawned more ambitious projects of development finance than others (allowing for interactions involving multilayered governance), and their levels of success or failure have varied considerably (Bräutigam & Gallagher, 2014; Katada & Liao, 2020; Liao, 2019). Much valuable research on the institutional landscape of MDBs' financing stresses how, beyond cooperation with the recipient countries' national governments, Western MDBs have built coalitions across opposition and civil

society organizations (Öge, 2017). In particular, it has been emphasized that modern development financing is increasingly shaped by processes that have a sub-national, not merely national, character. In turn, the dynamic contest between opposing Western and Chinese lending interests is expected to intensify in many sites of political contestation in recipient countries, from the subnational to national levels. However, the significance of such different levels of governance differs markedly in different economic sectors and types of activity, and, of course, in different parts of the world.

In central Eurasia, the strategic energy sector – where most foreign investment occurs – is still very much dealt with at a state-level, while sub-national opposition and civil society groups take a backseat in strategic considerations.<sup>3</sup> As noted in a recent report by the EBRD (2020e), in energy-related development finance across Eurasia, the nation-state (and state-owned firms) still operate across a wide range of issue-areas and have obstinately refused to go away. In fact, the evidence on development financing in Eurasia's energy sector does not bear out the image of multi-level governance. Instead, given that strategic energy goods are in the grip of a small elite drawing its power almost wholly from revenue provided by oil, gas and mineral reserves, governance is typified by a blurring of the state and informal networks distinction (i.e. local informal elites – including clan and business ties – that work closely with public ones at a diversity of levels, including regional, city and local government). As emphasized earlier, existing explanations allow no role for the agency of local informal networks and their interests in the analysis. This article advances an alternative explanation that focuses on individuals, networks, and domestic institutions in highly personalistic regimes as important factors shaping both Western and Chinese development finance strategies in central Eurasia.

Unsurprisingly, empirical evidence from our dataset as well as the surveyed WB Country Partnership Frameworks and EBRD Country Strategy Documents emphasize better energy governance, privatization of large state-owned enterprises, and climate targets, as they have always done. But the 'how' of Western lending has seen a change. Centred on good governance and norms transfer, efforts by Western MDBs to accelerate reform in Central Asia and the Caucasus had shown limited practical results in the first decade after independence. Over the last decade, they made no direct reference to the complex geopolitical environment of post-Soviet Eurasia despite considerable changes in political and economic circumstances, the most spectacular of which has been China's thrust into Eurasia with BRI. These disruptive changes notwithstanding, Western MDBs' strategies for spurring reform in the energy sector and beyond largely remained the same, save for occasional attempts at updating them. More recently, however, the interaction among Western and Chinese development finance institutions in the region has intensified and, as has been shown in the case of Japan-China rivalry in Asia, when competition increases development finance actors often do undertake similar economic statecraft tactics and strategies and forge growing institutional linkages (Chen, 2021; Katada & Liao, 2020): precisely the kind of mechanisms that the 'West vs China' dichotomy thesis underestimates. In the same vein, increasing 'coopetition', i.e. the co-existence of cooperation and competition between Western and Chinese funders in the development of energy governance across Eurasia has resulted in emulation strategies for establishing influence and forging tactical partnerships with local actors in the region.

On the Western MDB front, recent policies to boost leverage by changing domestic incentives in Eurasia appear to acknowledge the limitations of conditionality. For instance, an October 2016 EITI ultimatum meant risking the strategically crucial Southern Gas Corridor energy investment, as the WB and the EBRD signalled that investment in Azerbaijan's energy sector was conditional on its compliance with EITI norms (Economist Intelligence Unit, 2016). Such conditionality was not well received by senior figures in the government, who pushed back hard against the perceived interference by external powers in Azerbaijan's internal affairs and went on to mobilise less 'demanding' financiers. Two months later, the AIIB approved a loan of US\$600 million, the largest at that point, for the construction of the TANAP gas pipeline from Azerbaijan to Turkey. In the words of Elshad Nassirov, vice-president for marketing and investments at Socar, the state oil company: 'Chinese money was quicker'.<sup>4</sup> Unlike Western-led institutions such as the IMF and the WB, China's solo-financed loan packages are typically free of conditions that require implementation of a good governance agenda or strict social and environmental protections. Its flexible repayment packages are often secured with commodities.

In light of such competition, it has been noted that the prospects of advancing the scope for Western MDB leverage to sustain reform in post-Soviet Eurasia could be strengthened if the lenders themselves underwent reform to match some of China's efforts. Bhatti and Auty (2006) argue that even if the political willingness to accelerate reform exists on the part of Western MDBs, their tools are flawed due to piecemeal coordination and an inability to practice oversight to judge whether or not progress is being made. China's strategy differs: similar to O'Neill (2014), Bhatti and Auty (2006) argue that the brilliance of the Chinese strategy is that it builds a political coalition that acquires a vested interest in sustaining reform and the capacity to buy off the losers from reform within low-productivity sectors. In other words, the gradual reform strategy builds a local political constituency committed to China-friendly economic reform.

Our research shows that considering some of the engagement strategies discussed above, Western MBDs have, indeed, changed their policies to boost leverage by changing domestic incentives and by mimicking the Chinese approach in the region. The change does not only reflect a growing convergence in the 'what' of Western and China-led investments – green financing initiatives – but also in the 'how' component: while progress in spurring domestic incentives for reform has been slow in the past two decades, the evidence examined indicates that the new strategies of both the WB and the EBRD are more strategic and proactive than the ones they replaced. These actions suggest that Western and Chinese financing in central Eurasia should be reframed as occurring at two levels: the national level and the informal level. The overwhelming bulk of energy financing activity still takes place within, not across, national boundaries, and there is nothing new about the need to incorporate domestic state-society relations (de Graaff et al., 2020) and the mediating effect of domestic elites in recipient countries when accounting for cross-border development finance flows. But the usual framing of the IPE of energy in terms of state-centered competition actually masks the importance of more transnational networks of elites, companies and interests that span across different lending projects.

Nonetheless, scholarly analysis thus far has not addressed systematically the *interaction* of external development financing actors and local elites, and the possibility that both Western and Chinese developmental effects will not rest on the expanded energy access they generate per se, but rather the broader institutional framework within which this expansion takes place. Most energy initiatives in Central Asia and the Caucasus, whether economic or technological, are, in the early stages, open only to a small elite. Development financing thus has the potential to create transnational coalitions between the development assistance institution and elites at the local level. Over time, domestic groups that favor interdependence with the existing sources of development assistance will form and strengthen, and will inevitably exert influence over national policies in a direction preferred by them and the international lenders. Here, the interests of local illiberal leaders converge with those of external actors seeking tools of economic influence. As Cooley and Nexon (2021) conclude, Western powers, too, often support corrupt foreign officials out of economic or geopolitical interest. The presence of competitors such as China that care even less for economic liberalism further pressures liberal states to look the other way.

The next sections provide empirical support for these propositions about development finance practices of Western MDBs and China in Central Asia and the Caucasus and a more detailed analysis of the causal mechanisms that account for the dual transformation.

### **Western MDBs and China in Central Asia**

There has been a clear shift in the nature of the WB and EBRD's lending to Central Asian countries in support for their transition to non-hydrocarbon economies. EBRD's lending has backed the diversification of the Kazakh economy and low-carbon projects. The EBRD is now Kazakhstan's largest investor outside the oil and gas sectors (EBRD, 2020a). For example, in 2016 the EBRD committed \$200 million to the 'Kazakhstan Renewables Framework' (KazRef) and extended a further \$300 million to KazRef II in 2019. In terms of the '*what*', the framework supports 'the development of renewable energy projects and provides financing for the modernization of the electricity grid to enhance the integration of renewables' (EBRD, 2020b). KazRef II aims to further support competitive tendering of wind projects, bolster women's employment in the energy sector, and contribute to private sector development (EBRD, 2020b). However, it is the '*how*' that deserves attention as Western MDBs have begun to privilege different targets in Kazakhstan and across Central Asia: the pragmatic delivery of development strategies and cooperation with the recipient countries' governments to maximise success rather than just seeking to limit the footprint of the state are visible in EBRD's support of the Zhanatas Wind Farm as part of KazRef II, where the Bank emphasises 'policy dialogue activities with the Government to improve the regulatory and legislative environment for renewables generation [...]' (EBRD, 2020d).

Similarly, both the WB and the EBRD have been active players in support of Uzbekistan's transition to renewables. The activities of Western MDBs have increased significantly since 2017, when a political transition took place with current president Mirziyoyev's rise to power. To support the new administration's economic reform agenda, in 2018 and 2019 the EBRD committed \$400 and \$475



million, respectively, to Uzbekistan (BBC Monitoring Central Asia, 2019). The Uzbek Ministry of Energy and the EBRD are now developing a 'National Low Carbon Development Strategy', which includes a ten-year program to build 5 GW of solar and 3 GW of wind power plants. Similar to its approach in Kazakhstan, the EBRD aims to strengthen the private sector in Uzbekistan. For example, the Nur Navoi – a 100 MW solar plant – will be one of the only two privately owned power plants in Uzbekistan, whose power sector has thus far been solely controlled by the government (EBRD, 2020c). Similarly, in October 2019 the WB's International Finance Corporation signed an agreement with the Uzbek government to act as transition advisor on solar plants. Despite these grand liberalizing reforms, at the time of writing there are still no realised renewable energy projects in Uzbekistan. The larger challenge for Uzbek policymakers might be summed up as one of 'talking less, walking more'.<sup>5</sup>

A note is in order, however, about *how* the EBRD goes about supporting these projects. It has recently launched a 'Stakeholder Engagement Plan and Grievance Mechanism' (SEP) that applies to all of its major energy projects across Central Asia and the Caucasus to 'facilitate resolution of stakeholders concerns and grievances', 'undertake meaningful consultation with local stakeholders, respond to their feedback and consult them so as to promote better awareness and understanding of EBRD's strategies, policies and operations'.<sup>6</sup> Similarly, the main outcome of the WB's own SEP for the Nurek Hydropower Rehabilitation Project in Tajikistan emphasises 'a stronger public awareness of the Project across a wide range of stakeholders, including local communities NGOs, and other local institutions' (World Bank, 2020a). These examples show that EBRD's and the WB's new strategies for Central Asia and the Caucasus both implicitly recognise the limitations of linear 'policy diffusion' through IFI conditionality. Due to what Acharya (2004) has called 'norm localization', i.e. not wholesale acceptance or rejection of a norm but a state of partial contestation, it follows that reform through conditionality is likely to generate only muted enthusiasm from the public and hidden opposition from vested interests, which have no incentive to constrain themselves. In this sense, the article draws attention to the agency of local actors: usually ambitious attempts to raise governance standards accomplish their initial tasks; however, they rest on a large and reticent web of informal interests, demonstrating the linkages between the vested interests of the elites and feckless 'on the ground' implementation of the modernization policies across post-Soviet Eurasia (Gel'man, 2016). In Kazakhstan the EBRD now stresses that 'all key parties involved, with the Government's strong financial and personal commitment to reforms at the highest ranks should enable speedy and effective implementation' (EBRD, 2017, p. 9). The emphasis is on a more consultative approach to aid the recipient states facilitate what Schumpeter has called 'creative destruction' as explicated in the EBRD's latest transition report (EBRD, 2020e, p. 6), with an implicit acknowledgment that local elites will never allow creative destruction if it undermines the social and economic basis of their own power (Skalamera Groce, 2020). Transnational ties and resources, in turn, help in sustaining local elite groups (Cooley et al., 2018; Özcan, 2021). Since elite interests will be transformed by such transnational links, the subsequent reshuffling of behavior will lead to new interests and the formation of transnational coalitions to advance those interests.

In the domain of energy, under conditions of authoritarian elite politics in Central Asia and the Caucasus, the forging of transnational ties with the host country regime along with their informal elite networks (with a much lesser role for opposition movements and/or civil society, as democratic institutions lack the strength to integrate these contending interests and views) are critical for explaining the primary mechanisms by which the dual transformation occurs. The stress is no longer on penalizing officials who seek to terminate existing programs on the grounds of corruption or ineffectiveness but on maintaining tight relationships with key local stakeholders and making actors with key entry points in the implementation process interested in investments towards development (to minimise the risks of expropriation) as well as making them committed to reform implementation.

This type of *emulation* and consequent *diversion* in WB's policies is evident in its efforts across Central Asia and the Caucasus, where the emphasis lies on introducing innovative approaches that require 'a deep understanding of the local political economy context' (World Bank, 2015, p. 15). In Kazakhstan, the 'Country Partnership Framework' highlights that economic diversification requires improvements in the underlying business climate, a condition that is contingent on an efficient public sector and supportive local administration (World Bank, 2020c, p. 28). In that sense, the emphasis is on working with local elites to support the country's reform effort as opposed to an approach based purely on privatization, deregulation and a leaner state. In Uzbekistan, similarly, the World Bank (2016, p. 12) notes that a 'better understanding of the nature of the public administration, procurement, and financial systems, as well as the local culture, are essential for the success of institutional reform and capacity-building efforts'. Moreover, 'close alignment with government objectives, as well as continued intensive dialogue, are important for the success of the WB's program' (World Bank, 2016, p. 11).

All lessons-learned from the flawed, patchy, and slow implementation of previous projects were reflected in the design of new programs to better engage the economic and political interests among local stakeholders for strengthening the leverage of their particular institutions, as well as to accelerate reform, and then to reduce the likelihood of immediate opposition to reforms from vested interests. This new reform style is not dissimilar to that of China's 'close alignment with local government objectives' strategy. For instance, in Uzbekistan lucrative agricultural rents had been traditionally transferred to an elite opposed to reform in a way that damaged the development of a potentially competitive sector in the country and its long-term growth prospects. The WB now admits that high-level policy dialogue with actors 'calling the shots' is crucial for achieving a number of outcomes, particularly in agriculture (World Bank, 2016, p. 11).

At the same time, Chinese strategy in the region, too, has displayed an evolution in both the *what* and the *how* of investment. While the 'what' is rather obvious – a booming presence in the hydrocarbon, and increasingly, the renewable sectors of the countries examined – it is the *how* that is worth highlighting. Literature about China's energy diplomacy in Eurasia reflects China's general preference for bilateral arrangements over working through multilateral institutions. Expert interviews conducted for this project, likewise, coalesce around the notion that Chinese firms are typically loath to co-finance Western MDB projects due to their reluctance to abide by the environmental standards and procurement rules set by the WB and the



EBRD.<sup>7</sup> Accordingly, this has resulted in Chinese banks and state owned-firms financing joint ventures only with the much more pliable recipient countries, while maintaining the largest shares in investments and using their own contractors in the execution of projects.<sup>8</sup>

Our research highlights that, unlike in the past, China too has demonstrated gradual *emulation* and a resulting *diversion* in its approach; it has enhanced its renewables portfolio and increasingly pays homage to multilateralism by *cooperating* with Western MDBs rather than reflecting an adversarial ‘solo-player’ attitude. As our dataset highlights, there are a number of instances now where Western banks have teamed up with Chinese state-owned companies and the AIIB. For example, the AIIB co-finance two projects in Central Asia and two projects in the Caucasus with Western MDBs (see [Supplementary material](#), Appendix). These examples speak to the argument of a partial evolution in China’s energy diplomacy whereby bilateral relationships and influence through multilateral institutions co-exist in reaching China’s development aims in Eurasia. This begs the question: given its vast capital reserves and success in bilateral diplomacy, why would China voluntarily accept the constraints of multilateral development financing in the energy sectors of Central Asia and the Caucasus?

Beijing-controlled development finance institutions might wish to mimic Western projects in Central Asia and the Caucasus given that they are relatively new to the market of multilateral development financing.<sup>9</sup> There is still much to learn in order to bring their expertise and standards on par with those of Western MDBs, which explains why they are eager to get involved. As an interviewee pointed out: ‘Currently, the Chinese are free-riding on our standards, practices, human capital and even our offices, as they have not opened regional offices to support their operations in Central Asia. But in the longer term, inducing China to join our activities goes beyond a question of free-riding and may be mutually beneficial. The WB and the ADB face a capital squeeze and the Chinese partners come in with the money that is missing. In the long run their leadership in “green” technology may allow us to “free-ride” ... so it may be seen as a win-win development in the long-run ...’<sup>10</sup> As China’s global influence grows, such developments might reflect its efforts to tout its international citizenship credentials (Lo, 2016) along with a more sophisticated approach of spreading influence *via* rule-setting through collaboration with more experienced MDBs at a regional and sub-regional level. This allows China to (i) learn from them and (ii) ‘improve’ them to better serve China’s regional development goals and reflect its rising status. Moreover, this complements – but does not supplant – its more traditional bilateral loans and investments to some individual countries, for example Kazakhstan. For instance, our dataset includes thirteen bilateral Chinese investments in Kazakhstan’s energy sector worth about \$22 billion in addition to one project co-financed by Risen Energy and another by the AIIB (see [Supplementary material](#), Appendix).<sup>11</sup>

The mechanism of *cooperation* that this paper sheds light on is most visible in the joint lending in renewables, in particular solar energy and hydropower. Western MDBs and Chinese corporations partner in a growing number of renewable energy projects. In this process, Western MDBs have consolidated their commitment to good governance standards and in this sense have mimicked *the form*, but not *the content*, of Chinese initiatives across the region. As to form, their new emphasis on working with rather than past local governments, a relaxation of

conditionality requirements, and the stress on 'joint ownership' of the reform agenda have been tactical reactions to past failures as well as the rise of China as the region's primary investor. Meanwhile, and in light of the discussion above, it is not that surprising that Chinese corporations and the AIIB have agreed to abide by much more stringent environmental and social standards, as well as procurement regulations, to work together with Western MDBs. In Kazakhstan, for example, the EBRD, the AIIB and the Industrial and Commercial Bank of China (ICBC) co-finance the Zhanatas 100 MW wind power plant, which is part of the Kazakh government's above-mentioned Renewables Framework Program.<sup>12</sup> Similarly, in October 2018 the EBRD agreed to offer \$42,5 million for the construction of the 63 MW photovoltaic solar plant in Chulakkurgan, Kazakhstan. The project's sole operator is one of China's leading public enterprises in the solar industry, Risen Energy, and the project marks EBRD's first cooperation in the country with a Chinese company.

In Tajikistan, the WB and the AIIB agreed to co-finance the above-mentioned Nurek Hydropower Rehabilitation plant, which generates about 70% of Tajikistan's annual energy demand (World Bank, 2019). The WB, as the lead financier, will administer the AIIB's loan on behalf of the AIIB 'including procurement, environmental and social compliance' (AIIB, 2019). In addition to the WB's lending of \$226 million, the AIIB and the Eurasian Development Bank will provide \$60 million and \$40 million, respectively. One interviewee stated that, traditionally, Chinese firms refused to co-finance Western MDB projects as they were unwilling to abide by the environmental standards and the procurement rules set by the WB and the EBRD.<sup>13</sup> Nevertheless, we have demonstrated that the AIIB, as one of the two China-led MDBs alongside the BRICS' New Development Bank (NDB), has been open to voluntarily accepting the constraints attendant upon multilateral action when taking such steps allows China to free-ride on some Western standards and to learn from and mimic Western programs in a way that profits its own regional development goals. In the energy projects it has thus far co-financed in Central Asia and the Caucasus, the AIIB has embraced the WB's and the EBRD's environmental, societal and procurement standards, thereby demonstrating a willingness to cooperate with rival MDBs and to adopt international governance regulations despite operating in a still largely authoritarian post-Soviet Eurasia.

### ***Western MDBs and China in the Caucasus***

The dual transformation that this paper uncovers is also visible in the Caucasus, another post-Soviet region with intensifying Western MDB and China-led lending in the energy sector. In the Caucasus, the WB and the EBRD are now committed to promoting (1) a version of gradual reform not unlike that of China-led development funders, and (2) bottom-up support for reform by encouraging local governments' 'co-ownership' of reform efforts, and (3) a relaxation of conditionality. A note of caution, however, is warranted. While democratic countries not only permit but positively encourage the possibility of the mobilization of grass-roots movements, civil society groups and NGOs, non-democratic states usually maintain a high degree of control over civil society organizations, including the right to close them down if they are deemed a challenge to the worldview of the authorities. Control over strategic sectors of the economy, such as energy, is tightly held in the

hands of state-backed local elites. So, in countries that have undergone processes of 'authoritarian modernization' such those of Central Asia and the Caucasus, 'governance' has given way to a tighter yet more amorphous set of processes that blur the distinction between the national level and private realms of informal local networks, through which resources are distributed and coercion applied (Hale, 2014). In the highly personalistic regimes of post-Soviet Eurasia, *personal ties* and informal networks are critical means of engaging foreign financing in the strategic energy sector (Skalamera Groce, 2020) – especially as revenues from raw materials and the hydrocarbon sector account for 15% of government revenues in Uzbekistan, one third in Kazakhstan and about 75% in Azerbaijan.

For instance, the 'lessons learned' sections of both the EBRD Country Strategy documents and the WB's Country Partnership Frameworks for the Caucasus in broad strokes highlight that local stakeholders ought to be more deeply invested in the reform effort so as to make reform more conducive to success. In Armenia, the EBRD (2019b, p. 7) underlines the need to 'seize opportunities for deeper engagement with the new reform-oriented government'. In Azerbaijan, likewise, the emphasis is on 'improving the country's business environment through enhanced dialogue between the local public and private sectors' (EBRD, 2019a, p. 7); in Georgia, yet again, the EBRD (2016, p. 9) pledges to 'continue to leverage its working relationships with local banks, in order to mitigate some of the risks'.

In Armenia and Georgia, sustainable development through 'greening' has occupied a strong place in the lending portfolio of Western MDBs. The fact that Armenia and Georgia largely lack natural resources has allowed Western MDBs to concentrate their lending practices on private sector development. In these two countries the share of the private sector in the EBRD's portfolio is 85% and 53%, respectively. For example, in 2015 the EBRD approved lending worth \$120 million for the Georgian Low Carbon Framework (EBRD, 2015). On the other hand, the WB prepared a SEP for the Energy Supply Reliability and Financial Recovery Project, which includes the construction of an electricity transmission line that can create grievances among the local population (Georgian State Electrosystem, 2019). Similarly, the World Bank's SEP for the Armenia Mineral Sector Policy II envisions a clear strategy to engage with local stakeholders to 'ensure their broad and active participation', 'establish a constructive dialogue' and communicate the importance of the project for Armenia's sustainable economic growth (World Bank, 2020b, p. 6). In Azerbaijan, however, the share of the private sector in the EBRD's portfolio stands at a mere 22%, making it the lowest figure in the Caucasus. Similarly, aside for the TANAP natural gas pipeline project, the WB has not been a very active lender in the energy sector of Azerbaijan. From 1995 to 2020, the WB provided about \$420 million for fourteen projects other than TANAP in Azerbaijan's energy sector (see [Supplementary material](#), Appendix).<sup>14</sup>

Compared to Central Asia, the Caucasus has thus far attracted much less attention from China. The Chinese giant CNPC made a rather impactful entry into Azerbaijan's energy sector by investing in the Kursangi & Karabagly oil field in 2002 and further consolidating its presence by financing the Gobustan oil field in 2003 (CNPC, n.d.). The region constitutes an important gateway to Europe and thus the gate to expanding economic influence through the BRI, yet Chinese state-owned corporations have only recently beefed up their presence in the energy sectors of the three regional countries. Our dataset includes eight Chinese projects in

the Caucasus worth a total of \$1,3 billion. Remarkably, five of these projects are power plants and thus far Georgia retains the lion's share with four power plants: since 2006 Chinese state-owned enterprises have invested in two thermal (Ghardabani and Tkibuli) and one hydropower (Khadori) plant worth a total of \$392 million. At the time of writing, China is involved in negotiations for a power plant in Armenia and has financed the construction of another in Azerbaijan. Similar to its *cooperation* approach in Central Asia, the AIIB has co-financed energy projects in the Caucasus alongside Western MDBs. For example, the Nenskra hydropower plant in Georgia is co-funded by the Korean Development Bank (KDB), the European Investment Bank (EIB), EBRD and the AIIB. The largest lender is the EBRD with \$214 million, while the AIIB will provide \$100 million. The borrower of the project is K-Water, a Korean state-owned enterprise. Importantly, the EBRD categorises the project as 'A' in terms of environmental standards, and the AIIB has accepted the EBRD's environmental, social, and performance requirements – thus *emulating* and learning by modifying its own practices (*i.e. diversion*).

In the Caucasus, in addition to the WB and the EBRD's 'greening agenda', Western investors have been closely involved in the Southern Gas Corridor (SGC). This Western-backed gas conduit sits on a geopolitical fault line between the West and the East, and here strategic factors have prevailed in shaping the lending practices of Western MDBs. By extension, lending to Azerbaijan appears to be driven by strategic (geopolitical) considerations. These investments, unlike the ones described above, have very little to do with the otherwise prevailing 'greening' agenda of Western MDBs. The EU's energy security strategy has centred on investing in energy-infrastructure to purchase Caspian gas, with the goal of decreasing Russia's energy influence across the Caucasus and in Europe. The largest lender of the SGC has been the EIB, which has provided a total USD 2.8 billion for the construction of TAP and TANAP. For the TANAP alone, the WB has loaned USD 800 million, while the EBRD (where EU member states and EU institutions hold a majority of shares) has loaned a total USD 500 million to the pipeline. Other prominent funders have been the ADB and the AIIB (USD 0.6 billion) (Köstem, 2019, p. 649), which, as noted above, joined once the Western MDBs' conditionality agenda provoked the local elites to turn to less 'selective' funders.

While the TAP and TANAP pipelines have been largely financed by Western MDBs (see [Supplementary material](#), Appendix), any further expansion of the SGC is unlikely in light of Europe's low-carbon transition and America's shale revolution. Considering the lack of Western company investments and the neglect by the U.S. and EU leadership in developing new energy projects, Caspian oil and gas outputs are increasingly moving towards Asian markets. It is worth watching how the especially prominent EBRD investment in the Azerbaijani off-shore Shah Deniz gas field and the SGC transmission infrastructure will evolve going forward considering these large changes in the global geopolitics of energy, and whether any links can be drawn between the international economic statecraft of Western MDBs and the domestic priorities of important stakeholders within their ranks.

## Conclusion

At present the dynamics of interaction between Western MDBs and China-led development organizations such as the AIIB, and the influences driving mutual

learning and emulative strategies in Eurasia, are poorly understood or documented, and critically undertheorized. Our article conceptualizes the dual transformation that is underway, whereby cooperation and competition co-exist in the interactions of Western MDBs and China-led development finance institutions in the energy sectors of Central Asia and the Caucasus. To be sure, some forms of classically competitive behaviour have grabbed the headlines, such as investment in Kazakhstan's lucrative oil sector (Skalamera Groce, 2020). But zero-sum competition has hardly operated in isolation and, instead, leading development finance actors on both sides have learned from one another, thereby transforming their lending norms and practices.

This article reveals that the posited showdown between the Western and the Chinese approaches has not resulted in a binary contest. Such zero-sum categorizations are not useful for explaining the various ways in which recipient countries in Eurasia responded to Western and Chinese development financing, both at state and informal network levels. That said, our 'dual transformation' argument does not entail a future that is free from competition between Western MDBs and Chinese development finance actors. The future of development finance will, however, be of a multi-layered and multi-actor character, marked by convergence as well as competition between various Western MDBs and state-owned banks in China, Japan, South Korea, etc.

While consolidating support for *the content* of their policies (i.e. the backing of low-carbon projects and a diversification away from hydrocarbons), *the form* of Western MDBs' engagement has changed. They now focus on an approach that prioritises working with local actors, not least with local governments (and their informal patronage networks), to foster policy implementation and maximise the success of reforms. In turn, after a decade of unilateralist strategy based on a strong preference for bilateral diplomacy and energy mercantilism, China and the China-led AIIB have started to embrace the environmental, social, and procurement standards of Western MDBs. This is visible not only in investments in renewables, but also with TANAP, which connects Caspian gas to the European markets. Although co-financed projects (AIIB or other) constitute a minority of Chinese development finance in Eurasia (see [Supplementary material](#), Appendix), they nevertheless demonstrate an important shift in China's lending practices. Beijing's recent official document, 'China's International Cooperation in the New Era' similarly emphasizes the need for growing cooperation between Chinese and international development finance actors (The State Council, 2021). However, it is too early to predict what kind of an effect the document will have on Chinese foreign aid and development finance practices overseas.

Our findings are relevant to both theory and policy. First, they show that the 'West vs. China' dichotomy based on 'neoliberalism vs. state capitalism' has become blurred as different Western development finance actors and China-led institutions and firms have emulated each other's tactics and learned from each other more generally (Chin, 2012; Katada & Liao, 2020) and in energy markets more specifically. Therefore, our article's argument echoes the recent literature on China's hybrid mode of engagement with the global economy (de Graaff et al., 2020). Second, our findings have important implications for the policy debate on the role of development finance institutions in the energy sector of the smaller countries of Central Asia and the Caucasus. These actors are not passive takers of

the conditions set by Western MDBs or Chinese state-owned companies but, instead, reconstruct the ‘imported’ policies to ensure a better fit with local norms and practices.

While the article primarily focuses on Eurasia, we expect the process of dual transformation to take place in other regions of the global economy as well. This process is also not necessarily limited to the energy sector. Cooperation between the Chinese policy banks or the AIIB on one hand, and the WB or other MDBs on the other is already under way in Africa and Southeast Asia. As Chin (2012) shows, the 2007 Memorandum of Understanding between the Chinese Exim Bank and the IRBD was a turning point. In 2014, the African Development Bank established the Africa Growing Together Fund with CDB, Exim Bank and the Agricultural Bank of China. Many other co-financed projects have followed.<sup>15</sup> In Southeast Asia, similarly, the ADB and China-led lenders have co-financed several energy and transportation projects. One primary example is the Greater Mekong Subregion: Northern Economic Corridor Project, which the ADB, China and Thailand co-financed from 2004 to 2009 in Laos.<sup>16</sup>

Future research should delve deeper into these co-financed projects to explore how dual transformation takes place through different levels and types of interaction. Indeed, this article points to important questions for future research. We need to better understand the dominant types of lenders’ interactions in recipient countries at different levels and under what conditions lending institutions can bring political change in an environment in which (i) elite interests influence economic policy directly and (ii) development finance intermingles with authoritarian elite politics in a volatile way, especially in the wake of failed democratic transitions across the post-Soviet space and elsewhere.

## Notes

1. Phone interview with local energy expert, 20 October, 2020.
2. Phone interview with retired ADB country director, 5 November 2020.
3. On the role of national elites in the implementation of Chinese railway projects in Southeast Asia, see Lim et al. (2021).
4. Phone interview, Elshad Nassirov, vice-president for marketing and investments at Socar, 3 November, 2020.
5. Phone interview, local energy expert, 20 October 2020.
6. This provision features in all the major EBRD Project Summary documents across Central Asia – see Chalakkurgan Solar, the Karaganda Solar Phase II project and the KazTransGas Solidarity Loan in Kazakhstan, the UzbekEnergo Muruntau Substation, and Climate Resilience Framework in Uzbekistan, and the Energy Efficiency Framework in Tajikistan. All EBRD project summary documents are available at <https://www.ebrd.com/work-with-us/project-finance/project-summary-documents.html>
7. Online interview with retired World Bank country director, 25 October 2020.
8. Phone interview, local energy expert, 20 October 2020.
9. Phone interview with retired ADB country director, 5 November 2020.
10. Phone interview, retired ADB country director, 5 November 2020.
11. In terms of bilateral loans and investments, the leading Chinese development finance actor in Kazakhstan is the China Development Bank (see [Supplementary material](#), Appendix).
12. AIIB is the biggest lender for the project with \$46,7 million, and the EBRD will provide \$26,1 million. ICBC will contribute with a further \$13 million to finance the project. The borrower, the Zhanatas Wind-Power Station LLP, is owned by the state-owned conglomerate China Power International Holding Limited (80%) and the



Visor Investment Cooperatief U.A., a Kazakh private holding company (EBRD, 2020c).

13. Online interview, retired World Bank country director, 25 October 2020.
14. As of writing, TANAP is the only active project that the World Bank provides lending for in Azerbaijan's energy sector (see [Supplementary material](#), Appendix).
15. In 2015, the CDB established the Investing in Africa Forum in partnership with the WB. In 2014 Chinese ExIm Bank and the WB agreed to co-finance the South Sudan-Eastern Africa Regional Transport, Trade and Development Facilitation Program (Phase I). In 2018, the AIIB and the WB agreed to co-finance the Sustainable Rural Sanitation Services (Phase II) in Egypt, making it the second cooperation in the country between these two MDBs.
16. Later, in 2009, the ADB and the Chinese Exim Bank signed a co-financing agreement to address the infrastructure needs of developing Asian countries. Since the AIIB's creation, the ADB has co-financed six projects in Southeast Asia in energy, health and economic resilience sectors.

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## Disclosure statement

No potential conflict of interest was reported by the author(s).

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