The EU, Central Asia, and the Development of Continental Transport and Trade

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Contents

Abbreviations

ADB	Asian Development Bank
ASEAN	Association of Southeast Asian Nations
ASEM	Asia-Europe Meeting
CAREC	Central Asia Regional Economic Cooperation Program
CARs	Central Asian Road Links
CIS	Commonwealth of Independent States
EBRD	European Bank for Reconstruction and Development
EEU	Eurasian Economic Union
IMF	International Monetary Fund
NSR	New Silk Road
OBOR	One Belt, One Road
RECCA	Regional Economic Cooperation Conference on Afghanistan
RETRACK	Reorganization of Transport Network by Advanced Rail Freight Concepts
SREB	Silk Road Economic Belt
TAPI	Trans-Afghan Pipeline Initiative
TRACECA	Transport Corridor Europe-Caucasus-Asia
TSR	Trans-Siberian Route
WTO	World Trade Organization

Executive Summary

Since the collapse of the USSR, a number of initiatives have embarked on the momentous task of rebuilding trade and transportation arteries between Europe and Asia across Central Asia and the Caucasus. The underlying logic has been twofold: by reconnecting the landlocked new states of the region to their neighbors and historic trading partners, the heart of Asia can become a land corridor connecting Europe to Asia. This was the rationale behind the EU's visionary but poorly implemented TRACECA project (Transport Corridor Europe-Caucasus-Asia). Since 1998, when the EU co-hosted a conference in Baku on the "Restoration of the Historical Silk Road," the term "New Silk Road" has gradually gained currency in various projects. Indeed, the past several years have seen a competition of initiatives. The U.S. launched its New Silk Road (NSR) initiative in 2010, which nevertheless failed to get the endorsement from the Presidential level needed for its success. Three years later, China launched the Silk Road Economic Belt, itself part of China's broader "One Belt, One Road" initiative. More recently, following Indian Prime Minister Narendra Modi's visit to the region, India has also begun to formulate its own version of Eurasia's emerging web of transport while Pakistan is pursuing a similar but as yet uncoordinated course. It is remarkable that the EU, which pioneered the concept of reopening continental transport a generation ago, is now absent from the list of leaders of this grand project. Overland trade links offer great potential benefits, but the future corridors are still only in a formative stage. Approximately 90% of the cargo from Europe to China is transported by ship via the Suez Canal; most of the remaining volume is flown by air, without stopping in Central Asia. The overland corridors traversing Central Asia are shorter compared to sea routes, but are presently inefficient and, in some cases, relatively expensive. Several obstacles must be overcome in order to make overland transport corridors genuinely competitive. Notable among these are slow borders, but other causes for delay range from impediments in the

legal, economic, tax, organizational, and banking sectors to issues with security and communications. Furthermore, there is to create integrated and competitive intermodal transportation and logistics networks across the region. The fact that Central Asia is landlocked compounds these problems, but the heart of the problem is that bottlenecks in one section of a given route end up affecting the entire route and those trading along it.

Thus, overland trade is still in its infancy. This is in spite of China's increasing trading ties with Eastern and Central Europe, which would be particularly suitable for overland or intermodal transport. China's trade with Eastern and Central Europe increased nearly tenfold from 2002 to 2013, from $6.8 billion to $58 billion, while its trade with all CIS countries together expanded from $16 billion to $153.5 billion during the same period of time.

Initiatives to ameliorate the situation have been many. But importantly, initiatives from within the region itself have played a crucial role. All Central Asian states have formulated and begun to implement transport plans and strategies, which have resulted in improved connectivity within the region and new links to Afghanistan. The integration of road and rail networks stands out as particularly promising. Examples include the recently inaugurated Zhezkazgan-Beineu and Arkalyk-Shubarkol rail links in Kazakhstan, completed at a cost of $2.7 billion. The section between Shalkar and Beyneu alone will reduce the transport distance between China and Europe by more than 1,000 kilometers (625mi). A second and equally important Eurasian land corridor is that which connects India/Pakistan with Europe and the Middle East. Traditionally, Central Asia played a significant role in this 'southern corridor.' while development of this route lags at least a decade behind the China-Europe corridor, its long-term potential may be even greater, given the striking demographic characteristics of the Indian Subcontinent as compared with China. Turkmenistan's new road and railroad, the Pakistan port of Gwadar, Afghanistan's ring road, and the TAPI pipeline are all elements in this future emerging and vitally important corridor. In 2011, Kazakhstan completed construction of the 293km (182mi) Zhetygen-Korgas rail link, which connects southern Kazakhstan with the Chinese border—thereby opening a second China-Europe link across its territory in addition to the

Alashankou border crossing. The construction of the $1.9 billion Angren-Pap rail link in Uzbekistan, which will connect Uzbekistan's portion of the Ferghana Valley with the rest of the country, has been approved, and the 928km (576mi) Uzen-Bereket-Gorgan railway now links Kazakhstan and Iran via Turkmenistan. To the West, opportunities for transit across the Caspian Sea have increased considerably. Kazakhstan has developed the port of Aqtau; Turkmenistan has substantially upgraded the port at Turkmenbashi; and Azerbaijan has built a major new port facility at Alat, south of Baku. Together, these three states have invested tens of billions of dollars in port development. Adding to this are the newly expanded Georgian ports of Poti and Batumi, and the projected port of Anaklia. These developments dovetail with the Baku-Tbilisi-Kars railroad, which will connect the Azerbaijani and Georgian railroads directly to the Turkish rail network; and the Marmaray project, which is digging a tunnel beneath the Bosporus that will connect the European and Asian sections of the Turkish railroad system. When these two projects are completed, a high-capacity railroad link from the shores of the Caspian to the European Union will be operational. Furthermore, the existing railroad connections to Georgia's Black Sea coast provide the opportunity to develop the maritime linkages to the Central and East European railroad system, particularly the Viking Railroad. This Railroad, forming a Baltic-Black Sea link, connects Lithuania with Ukraine via Belarus, a 1776km-run over 52 hours.

From a European perspective, a number of steps can be taken to further the development of continental trade. A key question is the placement of logistics hubs in the region. Being centrally located and bordering every Central Asian country including Afghanistan, Uzbekistan has considerable potential. And for future links between Europe and South Asia, Turkmenistan is also centrally located. Yet as European leaders consider the expansion of trade and transportation links, Kazakhstan occupies a unique position in at least three ways. First, by virtue of geography, Kazakhstan forms a one-country link between China and the Caspian Sea. Second, Kazakhstan is the Central Asian country that has gone the farthest in terms of deepening institutional cooperation with the EU, as evidenced by the signing of an enhanced EU-Kazakhstan Partnership and Cooperation Agreement this week. Third, in a regional context Kazakhstan offers an improving business

environment crucial to the establishment of a trading hub: In the World Bank's Doing Business 2016 ranking, Kazakhstan jumped 12 positions from 53rd the previous year up to 41st. If the EU were to take a more strategic approach to continental transport and trade, it will be natural to focus initially on the partnership with Kazakhstan. Importantly, this should not occur at the expense of a focus on other regional countries, but as a first step in what must ultimately be a regional effort that includes all Central Asian states, including Afghanistan. The heady potential has fed the prevailing enthusiasm, but it has also caused all parties involved to underestimate the challenges that must be addressed before such potential can be achieved. Four issues in particular deserve greater attention. While the program thus far has been dominated by governmental initiatives, future success will be determined as much or more by market realities, and will depend on the private sector. Therefore, the first challenge is to embrace and build upon the inevitable shift from activities initiated and funded by governments to market-driven activities in many spheres, which must exist for the project as a whole to succeed.

Second, it will be necessary to develop "soft infrastructures" along the route itself. Given its location and its status as the largest transit country between Europe and China, Kazakhstan is a likely and suitable locus for such activities, which should be developed both by Kazakhstan-based businesses and by Kazakhstan-Europe partnerships in many fields. The development of such businesses will benefit shippers in the East and West and at the same time be essential to garnering the local support within Kazakhstan, which will be instrumental if the New Silk Road is to be sustainable.

Third, the geopolitics of transport and trade must be fully understood and their importance acknowledged by clear-headed policies. It is in the interest of both Europe and Central Asia to ensure that no power gains the ability to monopolize or control the emerging East-West transport corridors. This means utilizing the existing road and rail links to Northern Europe via the Russian Federation. But it also calls for balancing that route with the emerging corridor to Europe via the Caucasus and Turkey. Failure to achieve such balance will imperil the success of the entire project.

Finally, to assure that both present and future phases of the project are informed by the insights to be gained from the analysis of longer-term developments on the Eurasian continent, and specifically the likely rise of the Indian sub-continent as a major economic force by the year 2040. Acknowledging this emerging reality, the European Union, Kazakhstan, and other Central Asian states should combine forces to advance the opening of the most direct and efficient transit corridors between Kazakhstan, Central Asia, and the Indian sub-continent. These should be understood as an essential but separate supplement to the Silk Road Corridor, and their creation should be a task for the transit countries themselves.

The successful development of continental trade requires close and effective co-ordination between the European Union and the transit countries of Central Asia. Such coordination must be based on their common interests as defined through careful analyses by both sides and by close consultation between them. Rather than define their common interests narrowly in terms of trade, the two sides should extend the inquiry into all matters that will be affected by the opening of Eurasian land corridors, including nearly all sectors of their economies, diversification, governmental institutions, national and regional security, and demography.

Introduction

Since the collapse of the USSR, a number of initiatives have embarked, separately or together, on the momentous task of rebuilding trade and transportation arteries across Central Asia and the Caucasus. The underlying logic has been two-fold: by reconnecting the landlocked new states of the region to their neighbors and historic trading partners, the heart of Asia can become a land corridor connecting Europe to Asia. This was the rationale behind the EU's visionary but poorly implemented TRACECA project, the acronym standing for Transport Corridor Europe-Caucasus-Asia. In 1998, when the EU co-hosted a conference in Baku on the "Restoration of the Historical Silk Road," the term "New Silk Road" gradually gained currency in various projects. Indeed, the past several years have seen a competition of initiatives. The U.S. launched its New Silk Road (NSR) initiative in 2010. Three years later, China launched the Silk Road Economic Belt, itself part of China's broader "One Belt, One Road" initiative. More recently, following Indian Prime Minister Narendra Modi's visit to the region, India has also begun to formulate its own version of Eurasia's emerging web of transport. It is remarkable that the EU, which pioneered the concept of reopening continental transport a generation ago, is now absent from the list of leaders of this grand project.

Restored trade routes connecting Europe and Asia promise great benefits for the nations of Central Asia. The current and potential benefits of land trade between Europe and China are obvious: presently, large and heavy objects are transported by the slow but relatively cheap sea lanes, while fast but expensive air transport will always be used for small and lightweight objects. This leaves a large but unmet need for land transport that is faster than sea lanes but cheaper than air travel.

The U.S. NSR initiative was the first major external initiative to seek systematically to develop these trade routes. However, that initiative focused above all on

reconstituting north-south trade between Central Asia and the Indian subcontinent as a means of fostering economic development in Afghanistan. This was its principal concern, at least initially, which accounts for the fact that it did not provide for road or rail links from Central Asia to Europe. The program was subsequently revised to include the Caucasus, but the India-Central Asia connection via Afghanistan remains its principal objective. As a separate matter, the New Silk Road was entrusted to the State Department to develop, but has never enjoyed the presidential leadership that is needed for it to succeed. As a result, the NSR remains more declarative than real.

China announced its Silk Road Economic Belt rather suddenly in 2013, although many of its elements had been under highly visible development for a number of years before then. The announcement of the SREB, and the broader OBOR initiative, had the appearance of a public declaration of intent, as if China was moving fast to stake its claim in the transport sphere, perhaps in order to preempt Washington or anyone else from stealing the initiative. Most of the details had not been worked out at the time of the announcement, notably on how to finance the Asian Infrastructure Investment Bank. That said, the initiative holds considerable promise for the development of trade between Europe and Asia across Central Asia.

This paper will plot out the main lines of transport and trade development in Central Asia and its potential for both regional states and the European Union. Since Europe will inevitably play a central role in the emerging continental transport network, it is all the more important to identify clearly the strengths and limitations of the existing arrangements and the steps that must be taken if both Europe and Central Asian states are to anticipate and seize future opportunities.

To this end, the first section of the paper presents an overview of existing arrangements and plans, most of which are well-known. The second section, which constitutes the heart of the paper, seeks to look two decades into the future of Eurasia-wide transport and trade. On that basis, it identifies four major emerging issues that are bound to become important both to Central Asia and Europe but which to date have scarcely attracted attention. All are visible today in embryonic form and should have been the subject of analysis and policy-making before now. But

this has not happened, in spite of the fact that these same challenges present genuine business and strategic opportunities for both Central Asia and the European Union.

The Resurgence of Transport and Trade across Eurasia

Central Asia's location at the heart of the Eurasian continent made it the most connected region in the world for 3,000 years. The so-called Silk Roads, which passed through Central Asia, provided overland links between the main commercial centers of China, the Middle East, and Europe. Other equally important ancient transport routes provided trade links between India, the Middle East, and Europe. Bringing wealth and prosperity, such long-distance trade also served as a valuable two-way conduit for the exchange of culture and technology between the major centers of civilizations in Europe and Asia. The resulting trade ushered in Central Asia's golden age.

But soaring tariffs and mounting insecurity along the land routes half a millennium ago fostered the opening of sea lanes between East and West that avoided Central Asia and the territory of Kazakhstan. Central Asia's role as a commercial hub faded. The economic and intellectual decay of the Central Asian emirates further isolated the region, a development that was exacerbated by the imperial advance of Russia and of British India, and their rivalry over the heart of the continent. With the creation of the Soviet Union, the ancient and diversified routes that once defined Central Asia were replaced by a single hub-and-spoke transport system oriented around Moscow.

A number of coinciding factors over the past two decades have created opportunities for a revival of overland trade across the Eurasian continent. These include the rapid growth in world trade, reduction in transportation costs due to improved technology and access to fuel, improvements in communications, China's opening up to the outside world in the early 1980s, the demise of the Soviet Union, and China's decision to invest in trade along its western border. Over the past two decades, the fall of the Taliban regime in Afghanistan and yet incomplete

moves toward normalized India-Pakistan relations have also advanced the possibility of reconnecting Central Asia with its major historic trading partner, the Indian subcontinent, and that region with Europe.

Combined, these diverse forces create an unprecedented opportunity for landlocked Central Asia to participate more fully in the world economy. Today, trade between the leading Eurasian economies, i.e., those at the western and eastern edges of the "world island," account for a preponderant share of global trade.[1] The re-integration of the Eurasian continent could potentially become what a World Bank report termed "one of the main defining features of the twenty-first century."[2] Restored trade corridors across the continent would mean that China, Russia, India, and Europe could more efficiently exchange high-value goods. Russia's backward Urals region and isolated Eastern Siberia could also benefit, while Kazakhstan, Uzbekistan, Azerbaijan, Turkmenistan, and Afghanistan all have the potential to become major or minor hubs along these re-emerging trading networks. Central Asia in particular could benefit from improved access to the goods, capital, and labor markets of its continental neighbors, not to mention the profits to be reaped from more traditional forms of transit trade.

Booming China-EU trade and other economic drivers of continental trade are gradually dissolving institutional impediments. Previously, Central Asia was an island of non-WTO states, while the surrounding countries—China, Europe, India, and Russia—were all WTO members. With the partial exception of Kyrgyzstan, which joined already in 1998, this factor has served as an impediment to continental trade. However, both Tajikistan and Kazakhstan have recently joined the WTO, and Afghanistan is close to joining. The membership of Central Asian countries in WTO could go some way towards removing existing institutional impediments to the extension of continental land trade.

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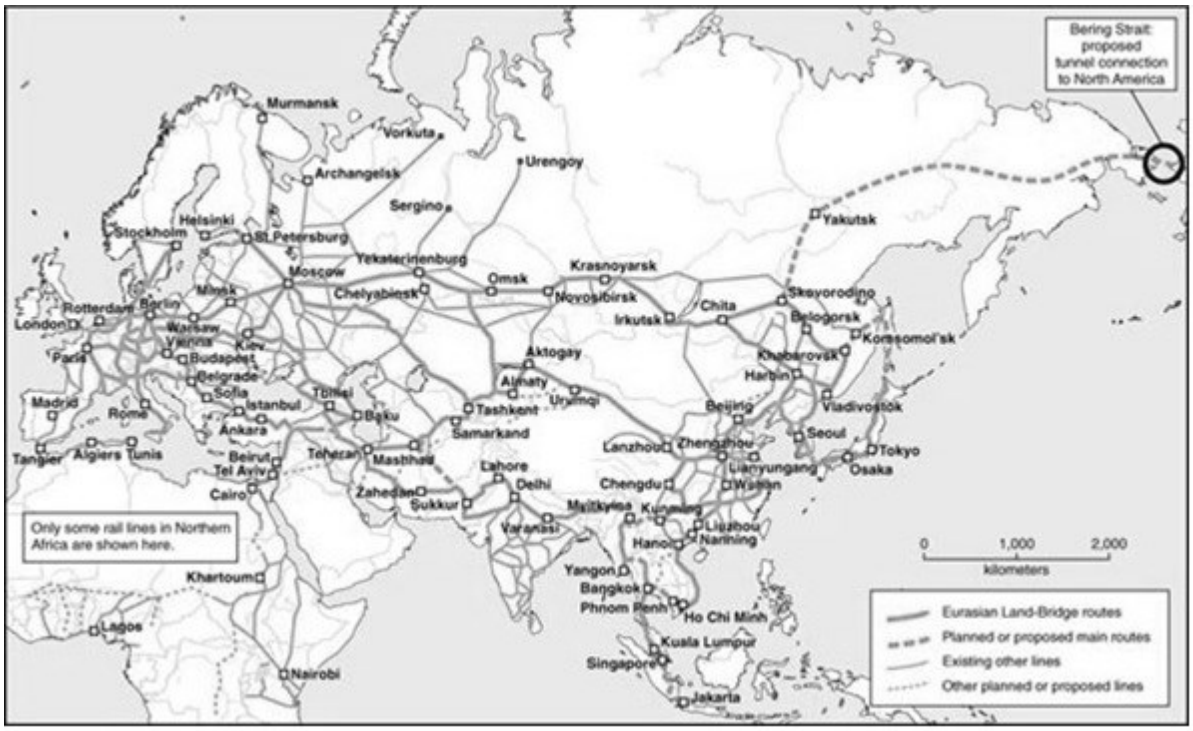
[1] Johannes Linn, "Central Asian Regional Integration and Cooperation: Reality or Mirage?" in *EDB Eurasian Integration Yearbook 2012*, ed. Evgeny Vinokurov (Almaty, Kazakhstan: Eurasian Development Bank, 2012), 96-117.

[2] Cordula Rastog and Jean-Francois Arvis, *Eurasian Connection: Supply Chain Efficiency along the Modern Silk Route through Central Asia* (Washington, D.C.: World Bank Group, 2014).

In theory, the formation of the Eurasian Economic Union (EEU) comprising Russia, Belarus, Kazakhstan, Kyrgyzstan, and Armenia should remove the post-Soviet customs barriers that have impeded trade and transit across the continent. But that has come at the price of forcing members like Kazakhstan to hike their tariffs against other trading partners. Moreover, Kazakhstan's membership to date has not insulated the country from discriminatory Russian infringements on free trade *within* the EEU.[3] In any case, it has become clear to many that the EEU is for now primarily a political project, and one that has yet to deliver its announced economic benefits.

Figure 1: Main Routes and Selected Secondary Routes, Eurasian Land Bridge



Overland trade links offer great potential benefits, but the future corridors are still only in a formative stage. Approximately 90% of the cargo from Europe to China is transported by ship via the Suez Canal; most of the remaining volume is flown by air, without stopping in Central Asia. The overland corridors traversing

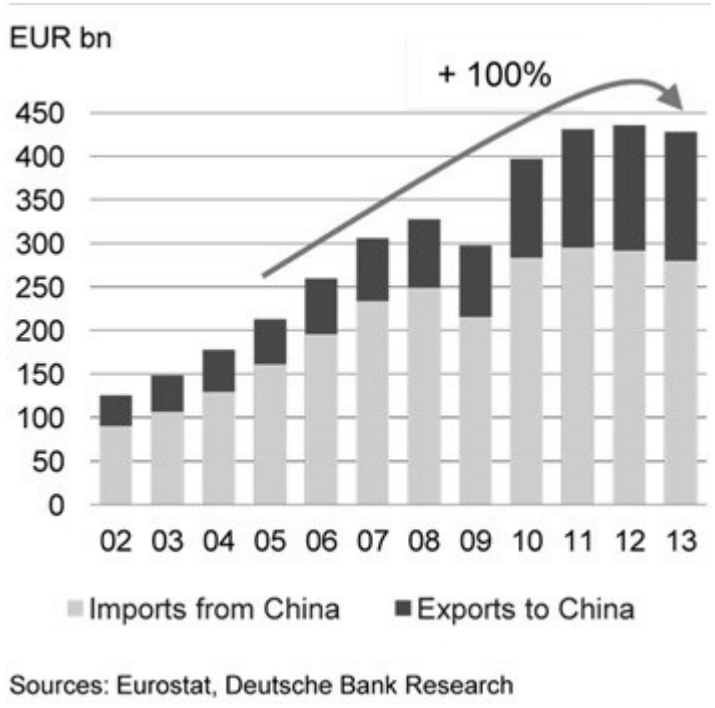
[3] Sergei Gretsky, "Hanging in the Trade Balance: Is Free Trade a Curse for Kazakhstan?," *Central Asia-Caucasus Analyst* 17, no. 11. June 10, 2015, http://www.cacianalyst.org/publications/analytical-articles/item/13228.

Central Asia are shorter compared to sea routes, but are presently inefficient and, in some cases, relatively expensive. Several obstacles must be overcome in order to make overland transport corridors genuinely competitive. These range from impediments in the legal, economic, tax, organizational, and banking sectors to issues with security and communications. Furthermore, there is a need to improve transport infrastructure, achieve greater efficiency at border crossings, and create integrated and competitive intermodal transportation and logistics networks across the region. The fact that Central Asia is landlocked compounds these problems, but the heart of the problem is that bottlenecks in one section of a given route end up affecting the entire route and those trading along it.

China-EU Trade: A Driver of the New Silk Road

The primary driving force of the new Silk Roads is the expanding trade between the European Union and China. From 2002 to 2013 EU-China trade increased from $93 billion to $560 billion.

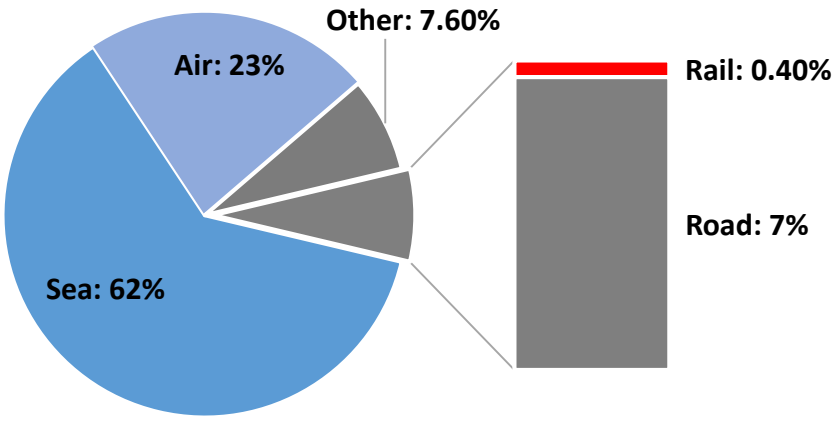
Figure 2: Doubling of EU-China Trade, 2005-13



Sources: Eurostat, Deutsche Bank Research

Today China is the EU's second-largest trading partner after the United States. The EU is China's largest trading partner:[4] in 2012, more than 90 million tons of goods were exchanged between the EU-27 and China.[5] The logic of the development of continental trade and transport links across Central Asia rests above all on capturing a portion of this burgeoning trade. Growing volumes on the overland links would also help cut transport costs and thus raise the competitiveness of this trade route and attract transport and logistics firms to make further use of these routes.

Figure 3: Means of Transport for goods traded (value), China-EU 2012



However, rail and road links still lag far behind sea-based transport options. This is the case both with respect to tonnage and to the value of products transported. In terms of value, 62% of the traded goods between EU and China in 2012 were transported by sea, 23% by air, 0.4% by rail, and 7% by road.[6]

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[4] International Monetary Fund Statistics Dept., *Direction of Trade Statistics Yearbook 2009* (Washington, D.C.: IMF, 2009); International Monetary Fund Statistics Dept., *Direction of Trade Statistics, June 2014* (Washington, D.C.: IMF, 2014).

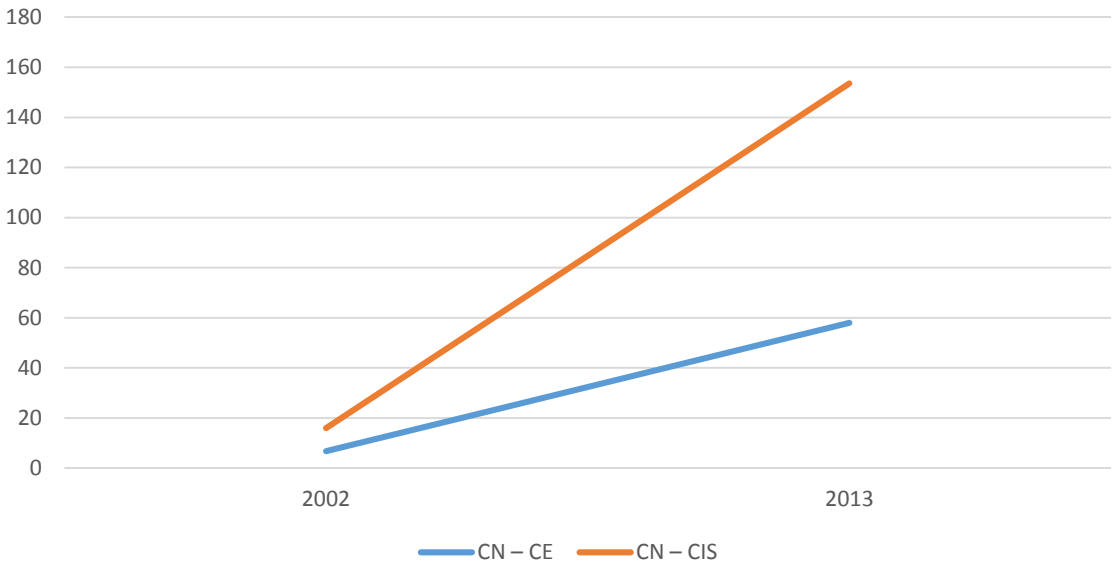
[5] United Nations Economic Commission for Europe, "Transport Links between Europe and Asia, New Challenges," August 30, 2013, http://www.unece.org/fileadmin/DAM/trans/doc/2013/wp5/wp5-eatl/EATL_8th_session_InfDoc1e.pdf.

[6] Ibid.

Even if overland links—especially railway—are competitive for high-value projects, the total tonnage of rail and road transport in EU-China trade actually *decreased* between 2006 and 2012, both in terms of exports and imports.[7]

In other words, overland trade is still in its infancy. This is in spite of China's increasing trading ties with Eastern and Central Europe, which would be particularly suitable for overland or intermodal transport. China's trade with Eastern and Central Europe increased nearly tenfold from 2002 to 2013, from $6.8 billion to $58 billion, while its trade with all CIS countries together expanded from $16 billion to $153.5 billion during the same period of time.[8]

Figure 4: China-CE, China-CIS trade 2002-2013, bln USD



The growth of both the Chinese and East and Central European economies fueled this growth in trade. Xinjiang, for example, has recorded an average growth rate

[7] Ibid.

[8] IMF, *Direction of Trade Statistics Yearbook 2009*; IMF, *Direction of Trade Statistics, June 2014*.

of about 10% since 1991,[9] while Eastern and Central European countries grew by an average of nearly 5% between 2000 and 2008.[10]

These factors have led to growing recognition of the further potential of overland trade and transport links. For instance, the official statement issued by the Milan Summit of the Asia-Europe Meeting (ASEM) (October 2014) noted the potential value of better connectivity and improved transport between Europe and Asia along the New Silk Road.[11] In April 2015, ASEM transportation ministers gathered in Riga for a meeting on "Euro-Asia Multimodal Transport Connectivity," and the 11th ASEM Summit taking place next year will be held in landlocked Mongolia. According to then President of the European Council Herman Van Rompuy, overland transport has now become "a priority" in Asia-Europe cooperation, drawing upon the experiences of trans-European networks and ASEAN's "Masterplan on Connectivity."[12]

The Central Asian Perspective

The five Central Asian countries are landlocked and their economies are relatively small. They are also far from equal, as Kazakhstan's GDP now exceeds those of the other four Central Asian states combined. All Central Asian states nevertheless have in common the fact that they are heavily dependent on imports for consumption. Because imports arrive over long-distance railroad and truck routes, transport costs are high.[13] For this reason, greater economic cooperation within Central Asia, as well as the improvement of links with Europe and the rest of Asia, is of critical importance to the region.[14] Beyond such potential economic

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[9] Deutsche Bank Research, "Province: Xinjiang," *Emerging Markets – China Chartbook*, September 2015, https://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000247542.pdf.

[10] Eric Labaye et al., *A New Dawn: Reigniting Growth in Eastern and Central Europe*, McKinsey Global Institute. December 2013, http://www.mckinsey.com/insights/economic_studies/a_new_dawn_reigniting_growth_in_central_and_eastern_europe

[11] Summit statements available at: http://www.consilium.europa.eu/en/meetings/international-summit/2014/10/16-17/

[12] Ibid.

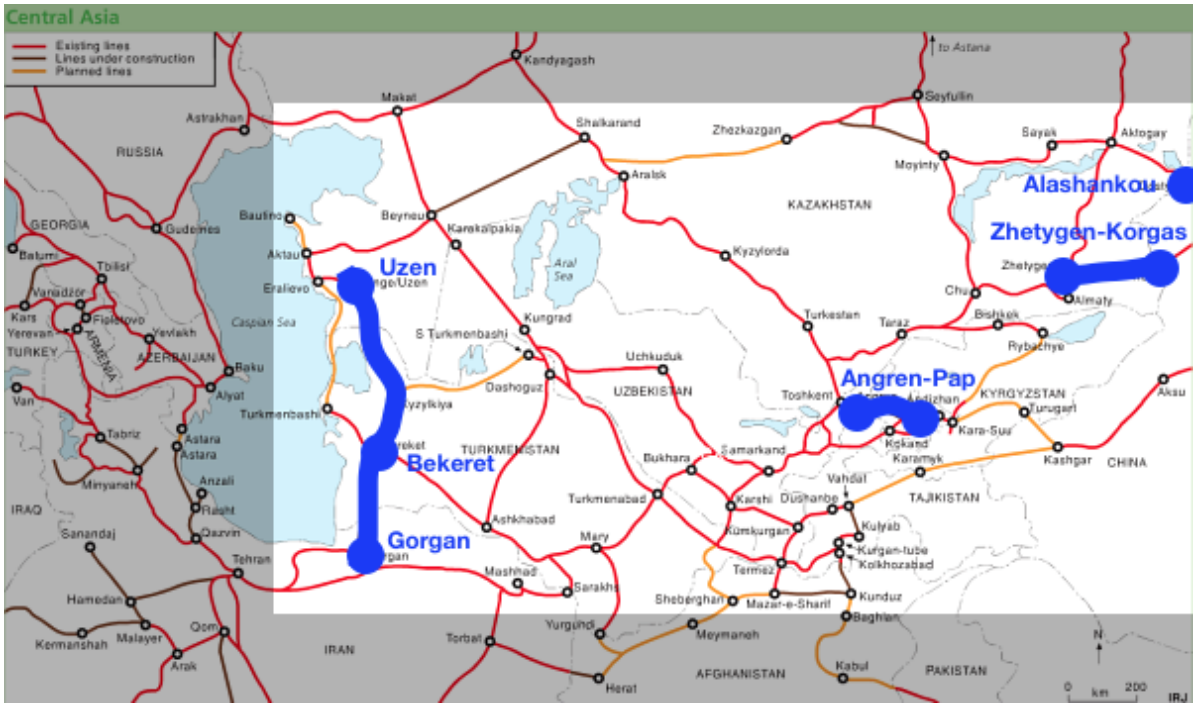
[13] Rastog and Arvis, *Eurasian Connection.*

[14] Linn, *Central Asian Regional Integration*.

gains, the diversification of trade and transport links will also strengthen the fragile sovereignty of the region's states.

As a result of the Soviet legacy, Central Asia has a developed but ageing transport infrastructure, with Kazakhstan and Uzbekistan having the largest rail networks in the region. Most physical infrastructural links are still available for trade and transport, but these relate largely to the old one-hub system centering on Moscow and not to the emerging patterns of trade.[15] The collapse of the Soviet Union disrupted many long-established economic links between the Central Asian republics and the rest of the former Soviet space, even as it opened possibilities for new directions of trade. The collapse of Soviet logistic systems also meant that new networks had to be set up from scratch. This, among other factors, contributed to a deep recession in Central Asia during the first decade of independence.

Figure 5: Map of Existing and Planned Railway Projects



[15] Rastog and Arvis, *Eurasian Connection*.

Following their recovery from the recession of 1998, the Central Asian economies have been growing steadily, with an average rate of growth of around 8-10% over the past fifteen years. The Central Asian states have worked to re-establish at least some trade links with each other, but the main emphasis has been on ties with their large external neighbors and with the rest of the world.[16] In 2002, trade among Central Asian states and Afghanistan was worth $953.5 million; but by 2013 this figure had reached $6.7 billion. During the same period, trade between Kazakhstan and Uzbekistan increased more than ten-fold.[17] However, even though intra-regional trade is important to certain relationships as, for example, between Kyrgyzstan and Uzbekistan, it comprises only a few% of Central Asia's total trade.[18]

All Central Asian states have formulated and begun to implement transport plans and strategies, which have resulted in improved connectivity within the region and new links to Afghanistan. The integration of road and rail networks stands out as particularly promising. Examples include the recently inaugurated Zhezkazgan-Beineu and Arkalyk-Shubarkol rail links in Kazakhstan, completed at a cost of $2.7 billion.[19] The section between Shalkar and Beyneu alone will reduce the transport distance between China and Europe by more than 1,000 kilometers (625mi).[20]

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[16] Linn, *Central Asian Regional Integration*.
[17] IMF, *Direction of Trade Statistics Yearbook 2009*; IMF, *Direction of Trade Statistics June 2014*.
[18] Rastog and Arvis, *Eurasian Connection*.
[19] "Kazakh President Flags off Opening of Railways Zhezkazgan-Beineu and Arkalyk-Shubarkol," *Interfax Kazakhstan,* August 22, 2015, https://www.interfax.kz/?lang=eng&int_id=10&news_id=7434.
[20] Igor Davydenko et al., "Potential for Eurasia Land Bridge Corridors and Logistics Developments Along the Corridors," *RETRACK Study for the European Commission*, July 2012.

link in Uzbekistan, which will connect Uzbekistan's portion of the Ferghana Valley with the rest of the country, has been approved,[21] and the 928km (576mi) Uzen-Bereket-Gorgan railway now links Kazakhstan and Iran via Turkmenistan.

Several rail lines have been upgraded and/or electrified, including those between Khorgos and Almaty in Kazakhstan, Tashkent and Termez in Uzbekistan, and Turkmenistan's north-south rail link through Serakhs.[22] Kazakhstan's railways have expanded by nearly 2,000km (1,250mi) since 2000, while Uzbekistan's have grown by over 500km (310mi) in the same period.[23] Such efforts led the World Bank to conclude that "substantial progress has been achieved in raising the quality of transportation links in the region, which has had substantial impact on the movements of freights and goods."[24] Similar progress is taking place in air connectivity. For example, the number of annual domestic and international flights taking off from Kazakhstan doubled from around 33,000 in 2010 to 70,000 in 2014; in Kyrgyzstan, they grew from 7,300 to 17,400 in the same period of time.[25] In all countries of the region, important efforts have been made to develop transport and trade:

- Kazakhstan's main priority is to raise the competitiveness of east-west links to China and Europe, as well as of the North-South Corridor to Turkmenistan and Iran. To promote these objectives, Kazakhstan has set up an international logistics centers for intermodal freight transport on the border with China, and invested heavily in the Aqtau port complex on the Caspian Sea.[26] In the second half of 2012, Kazakhstan opened a second border crossing with China at Khorgos, complementing the Dostyk/Alashankou crossing. Kazakhstan is also an important transit country for imports from Asia to other Central Asian countries, particularly Kyrgyzstan and Uzbekistan, and a hub for container traffic from

[21] "Uzbekistan Starts to Construct Railroad Angren-Pa," *UzDaily*, July 24, 2013, http://ieg.uz/archives/3113?lang=en
[22] Rastog and Arvis, *Eurasian Connection*.
[23] Statistics available at: http://data.worldbank.org/
[24] Rastog and Arvis, *Eurasian Connection*.
[25] Statistics available at: http://data.worldbank.org/
[26] Rastog and Arvis, *Eurasian Connection*.

China's eastern ports and Urumqi. Kazakhstan has cooperated closely with several external partners to promote trade, particularly with Azerbaijan, Georgia, and Turkey, to speed up border crossings and improve transportation links. At the 25th plenary session of the presidential council for foreign investors, President Nazarbayev set the ambitious goal of doubling transit through Kazakhstan by 2020, which would translate into 50 million tons of cargo.[27]

- Kyrgyzstan's main priority is to promote the six international road corridors that traverse the country, involving both north-south and east-west connections. The Kyrgyz Ministry of Transport has now proposed a second north-south link in addition to the Bishkek-Osh road and emphasizes further expansion of the rail network, which currently consists of only 450km (280mi) of track.
- Tajikistan depends heavily on Uzbekistan and Kyrgyzstan for transit traffic and has focused on developing additional outlets, including the rehabilitation of roads to China and Afghanistan. A new railway link between Tajikistan, Afghanistan, and Turkmenistan is under discussion, and a memorandum between the three has been signed.
- Turkmenistan has 22,000km (13,600mi) of roads and almost 2,500km (1,500mi) of railway, and has made some strides to promote the East-West Corridor by upgrading road and rail links to Iran and Afghanistan. Major investments in the main east-west road and railroads crossing the country and in the new port at Turkmenbashi reflect the country's strong commitment to improving transport connectivity.
- Uzbekistan has launched a $6.9 billion investment plan to strengthen its transport infrastructure and capacity. The plan involves mainly north-south links, including extending the existing railway link with Afghanistan and improving road links between Uzbekistan, Afghanistan, and the four other Central Asian countries. Uzbekistan has also actively promoted air

[27] Vladimir Fedorenko, "The New Silk Road Initiatives in Central Asia," *Rethink Institute Paper* 20, August 2013 (Washington D.C.: Rethink Institute).

> connectivity, with the result that it has become a hub between both South Korea and India as well as Europe. It has also expanded land-trade with South Korea by utilizing Chinese ports and the Dostyk-Alashankou crossing in Kazakhstan.[28]

In sum, the Central Asian countries have achieved noteworthy results in the building and reconstruction of road and rail networks over the past few years and have also gone some way towards establishing links with each other, employing a mix of their own funding and support from international development banks. Their ambition is that Europe and India will eventually join China and Russia by tapping into these links. The links with Europe and especially with India are largely underdeveloped at present, which is one of the causes of the diminishing importance of Central Asia's trade with both.

Central Asia's Changing Trade Patterns

The trading patterns of the Central Asian economies have changed markedly since the early 1990s, when they were still tied primarily to other countries in the former Soviet Union. Trade with Russia accounted for 47% of Kazakhstan's foreign trade in 1996 with the total volume of trade standing at $4.8 billion. Trade with China, by comparison, was a mere $495 million, or barely 5% of the country's total trade. In that year, Russia accounted for 24% of Uzbekistan's trade, 23.7% of Kyrgyzstan's, 10.6% of Tajikistan's, and 6.3% of Turkmenistan's. The trade of these four Central Asian states with China amounted to $241.7 million, which was less than 2% of the combined total of their trade volumes. All in all, Russia accounted for 31% of Central Asia's total trade.[29]

Since then, the Central Asian economies have increasingly reoriented themselves towards China, while trade with Russia has diminished in importance compared to other trading partners. Trade with the EU has grown in absolute terms, but remains constant in relative terms. Central Asia's trade with South Asia has increased, yet it is minuscule compared to its trade with Russia, China, and the EU.

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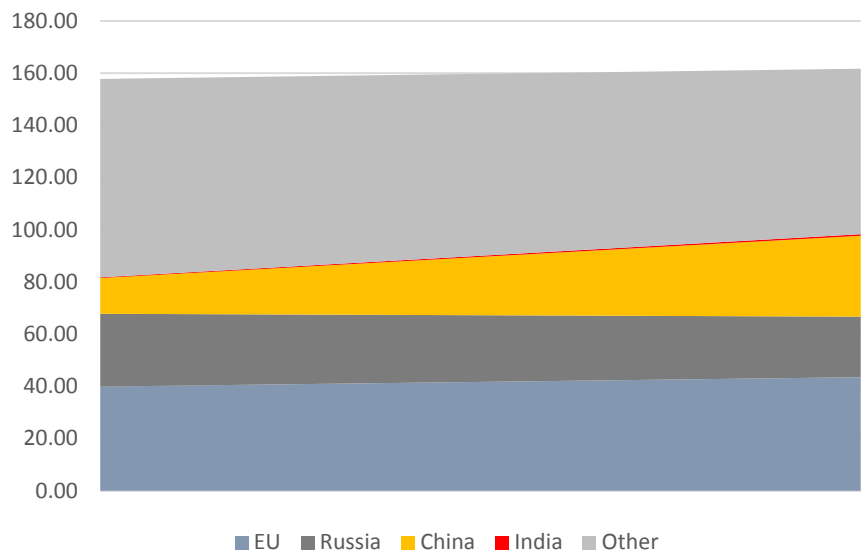
[28] Rastog and Arvis, *Eurasian Connection*.

[29] Statistics available at: https://sdbs.adb.org/sdbs/index.jsp

In 2008, Central Asia's total trade—imports and exports—was valued at $157.8 billion, of which the EU's share was $39.9 billion (25.3%), a slight increase from the early 2000s. Trade with Russia was worth $27.9 billion, or 17.7% of Central Asia's total trade. China's share, meanwhile, nearly doubled from the early 2000s to 13.7% or $21.7 billion in 2008. In striking contrast, India's share stood at a mere 0.26%.[30]

Figure 6: Total trade in Central Asia, 2008-2013, bln USD



These trends gained momentum in the years to 2013. Trade with China expanded rapidly in both relative and absolute terms, but trade with the EU grew slowly in absolute and relative terms. Trade with Russia shrank both relatively and in absolute terms, and trade with South Asia remained negligible, even while growing in absolute terms. Thus, out of Central Asia's total 2013 trade of $161.7 billion, the EU's share was $43.5 billion (or 26.9%), Russia's was $23.2 billion (14.4%), China's was $50 billion (31%), and India's $1 billion (0.6%).[31]

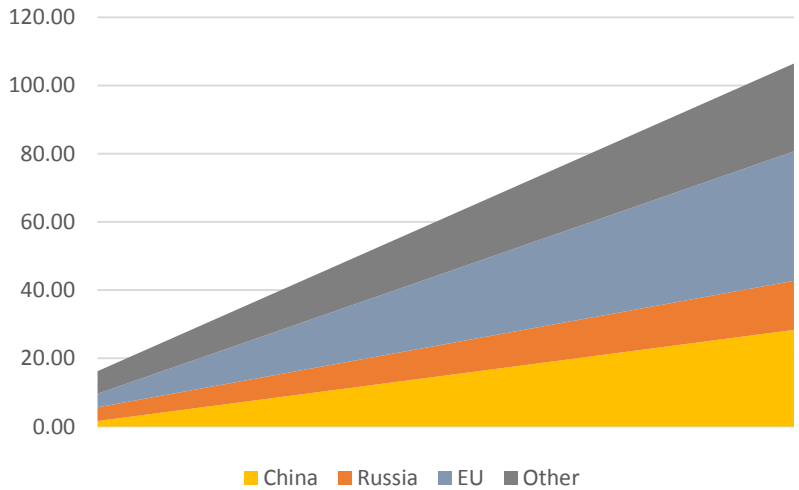
Aggregate statistics for Central Asia as a whole describe the changing overall patterns of trade in Eurasia, but country-by-country data tell a different story. The

[30] Data compiled from IMF, *Direction of Trade Statistics Yearbook 2009*; and IMF, *Direction of Trade Statistics*, June 2014.
[31] Ibid.

mere fact that Kazakhstan accounted for more than 60% of Central Asia's total trade in 2013[32] indicates the degree of differentiation that is obscured by the region-wide data. Trade between the other four Central Asian states and the EU is shrinking in relative terms, while the record is mixed in absolute terms. Trade with Russia is fairly steady while trade with China is booming.

In 2013, the EU accounted for more than a third of Kazakhstan's total foreign trade ($37.95 billion out of $106.47 billion), while the equivalent figures for China were 26.6% ($28.35 billion) and Russia, 13.5% ($14.4 billion). In 2002, the EU's share stood at 24.5%, China 10%, and Russia 24.7%. Over this period, Russia's share nearly halved, China's almost tripled, while that of Europe increased only incrementally.[33]

Figure 7: Kazakhstan's total foreign trade 2002-2013, bln USD



China accounted for nearly half of Kyrgyzstan's total foreign trade in 2013—$5.64 billion out of $11.93 billion, while trade with Russia made up slightly more than 20% and trade with the EU, 5%. In 2002, China's relative share was less than 10%, Russia's nearly 20%, and the EU's about 12%.

[32] Ibid.
[33] Ibid.

In 2002, trade with China made up only 0.6% of Tajikistan's trade, with Russia at 17.2% and the EU at 27%. By 2013, China accounted for more than 36% of Tajikistan's total trade ($2.14 billion out of $5.9 billion), while Russia's share had fallen to 14.2%, and the EU's share fell to less than 6%. Thus, China is advancing, the relative share of EU trade is shrinking, and that with Russia remains steady.[34]

Turkmenistan's trade with China grew from 2.3% of the total in in 2002 to almost half ($9.34 billion) of the country's total trade, amounting to $21.27 billion in 2013. The EU's share decreased over the period from 17.5% to 9.4% of the total volume, while that of Russia remained steady, declining only slightly from 7.7% to 7.5%. In other words, the EU's share of trade in Turkmenistan's total trading volume has shrunk by half over the past decade, Russia's share has remained flat, and China's trade with Turkmenistan has grown considerably.[35]

Turning to Uzbekistan, China's share of total trade has grown from a mere 3.8% in 2002 to nearly a quarter of Uzbekistan's total trade volume in 2013. Russia's share has declined somewhat from 22.3% to 20%, while the EU's share has shrunk from 27% to 10.7%. Again, trade with the EU has shrunk considerably in relative terms over the past decade, while that with Russia has remained flat. By comparison, China has become the country's most important trading partner.[36]

Thus, Kazakhstan stands out in the region, and skews the data for the region as a whole because of the size of its economy and its increasing openness to both Europe and China. When looking at the level of individual countries, Russia's share of trade has remained steady in the other four Central Asian countries or even increased from the mid-1990s. But the EU's trade with these four countries is in decline, which means that with respect to trade, Central Asia can be described as being solidly within the Sino-Russian orbit. In view of the fact that more than 70% of the EU's trade with Kazakhstan in 2013 consisted of EU energy imports, the rest being mostly Kazakh imports of EU machinery and chemicals, the inevitable conclusion is that the EU's TRACECA and other projects contained in Europe's

[34] Ibid.
[35] Ibid.
[36] Ibid.

Central Asia Strategy have failed to bring about any significant expansion of non-energy trade with Central Asia.[37]

[37] European Commission Directory General for Trade, "Kazakhstan Factsheet," October 20, 2015, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111670.pdf.

A Multitude of Initiatives

The opening (or reopening) of land trade across Eurasia has many causes, including improved communications, the expansion of global trade, and the rapid growth of the Chinese economy in recent decades. But the *sine qua non* of this important development was the collapse of the USSR. Under Soviet rule the border between Central Asia and China was hotly contested, nearly leading to war in the 1960s and remaining heavily militarized thereafter. The end of the Soviet system potentially opened the border to local and distant trade. China took immediate action and began the process of reopening continental trade that has reached a crescendo today.

Most global trade is between producers and consumers, with the former being mainly private or at least non-state enterprises. Governments and international agencies play an important but secondary role, collecting tariffs, preventing abuse of the system and, at times, helping with finance. But during the twenty years since the start of efforts to reopen transport links across Central Asia, governmental organs and international agencies have played an inordinately large role. This has resulted in a confusing welter of initiatives, organizations, interstate forums, official programs, and endless conferences, all of them on an official level. These activities have been extremely well funded, to the tune of tens of billions of dollars. To their credit, some of these initiatives have produced valuable results in the form of new infrastructure or more efficient conditions for trade, although formidable amounts of money have also been wasted. It is impossible to discern a productive path forward without first understanding the tens of governmental and trans-national official groups already working the field.

European Initiatives: From TRACECA to RETRACK

The European Union was the prime external mover in the efforts to develop trade and transportation across the heart of Eurasia. A conference of transport ministers of the eight countries of Central Asia and the Caucasus in 1993 conceived the Transport Corridor Europe-Caucasus-Asia project, which subsequently grew to include numerous countries along the intended corridor. This was followed up by a major conference in Baku in 1998. Since 2001, TRACECA has maintained a permanent secretariat in Baku. However, while TRACECA was launched to much fanfare, it fell short of expectations. The EU did implement some 60 technical assistance and investment projects at a value of ca. €120 million in a variety of areas, including the rehabilitation of border posts between Azerbaijan and Georgia, training of freight forwarders, and facilitating a host of agreements. But the most salient projects in the region have been conducted without EU involvement, most notably the Baku-Tbilisi-Kars railroad, which the EU and U.S. boycotted on the grounds that it sought to bypass Armenia.

Notwithstanding, TRACECA launched the "Silk Wind" initiative, a container block trade route connecting the Kazakhstan-China border to Turkey via a ferry between Aqtau and the Baku port of Alat. In August 2015, the first 82-container cargo train from China arrived in the port of Alat in six days; with the completion of the Baku-Tbilisi-Kars railway, trains will reach Europe in 14 days, compared to the 15-19 days for the route across Russia.

After many years in which the EU allowed TRACECA to lie seemingly dormant, it has now re-energized the project and it is achieving substantial results. In 2007, the European Commission launched "The Reorganization of Transport Network by Advanced Rail Freight Concepts" (RETRACK). This initiative identified four main competing overland railway corridors between China and Europe:

- The Trans-Siberian Route beginning in Northeastern China, heading north directly into Russia without crossing Mongolia or Central Asia, and ending in Moscow with further connections via Belarus to central Poland and Europe;

- The Trans-Siberian-Kazakhstan Route, which begins in western China, crosses Kazakhstan, and joins the Trans-Siberian in Russia;
- The TRACECA-Turkmenbashi route, which starts in western China, runs through Kazakhstan, Uzbekistan, and Turkmenistan, and then crosses the Caspian Sea, Azerbaijan, Georgia, and the Black Sea before terminating in Romania (a parallel route crosses only Kazakhstani territory, connecting across the Caspian from the port of Aqtau);
- The Central Corridor, which starts in western China, goes west via Kazakhstan to Russia in the south, before continuing to Ukraine and ending in Slovakia.[38]

The main objective of the RETRACK project was to connect the North Sea with the Black Sea, with a focus on connecting Europe to China's western provinces. While the program now appears to have ended, the RETRACK project is the only one to date which seriously examined the potential of overland railway transport between China and Europe. The study identified three potential European hubs for such traffic: Bratislava, Budapest, and Bucharest. From these three hubs, rail routes are envisaged to be further connected to China, with a new container terminal in Urumqi to serve as a hub.[39] These ambitions dovetail with the European Gateways Platform, which calls for greater use of seaports in Southern and Eastern Europe to accommodate traffic from the Black Sea and Caspian Sea areas.

Assuming constant trade volumes between the EU and China, the study found that the TSR and the Trans-Kazakhstan Corridor could potentially carry around 8% each of the total EU-China transport volume in 2020, provided that most physical and institutional barriers are removed. The TRACECA corridor, by contrast, has the potential to carry only around 1% of total transport volume according to the model, owing to the many obstacles along this route. The study concluded that the TSR and the Trans-Kazakhstan Corridor are the most attractive ones at present, "with the Kazakh corridor being slightly more attractive than TSR."

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[38] Davydenko et al., *Potential for Eurasia*.
[39] Ibid.

By 2020, the TSR is forecast to be most practical for railway transports from Northern Europe, followed by the Trans-Kazakhstan Route. This is due in part to the fact that the TSR route involves the fewest number of border crossings and transshipments.[40] Yet, of the four routes, the Trans-Kazakhstan Route potentially offers the shortest distance, shortest transit time, and lowest transport costs for cargo from China's coastal or inland provinces. If the transshipment at the Dostyk-Alashankou border crossing could be improved, the Trans-Kazakhstan Route "will be the most optimal option" for railway transport from Northern Europe to western China, according to the study. The Trans-Kazakhstan Route is also potentially the most attractive for railway transport from Southern Europe to China, and is estimated to remain so in 2020.

It appears unlikely that the TSR and the Trans-Kazakhstan Route could capture 8% each of the China-EU trade volumes by 2020, especially in light of low oil prices, which favor sea-borne options. Several obstacles also remain, including lengthy delays at borders. That being said, the potentials involved have been demonstrated by the great number of China-Europe block trains already making the journey. For example, the Trans-Eurasia Express connects Germany with China via Moscow and takes approximately 18 days in total. The DB Schenker China Express connects Leipzig to Shenyang and takes 23 days using the Trans-Siberian Route. Fesco Transportation Group runs a Baltic-Transit Container train 2-3 times a week, which offers rail transportation from the Baltic States to Central Asia, Afghanistan, and China using container block trains. SRR, a Latvian forwarding company, offers container block trains from Riga to Almaty, Bishkek, Tashkent, Dushanbe, and Afghanistan with an average transit time of 10 days. A Duisburg-Chongqing container train (known as the Youxinou railway in China) runs daily via Kazakhstan. Kaztransservice, in cooperation with a Belarusian transport company, is also operating a container train running from Brest to Dostyk/Alashankou. The transcontinental block trains are particularly competi-

[40] Ibid.

tive for high-value projects. Since 2011, for instance, Hewlett-Packard has transported 4 million notebook computers from its factory in Chongqing through Kazakhstan, Russia, Belarus, and Poland to Duisburg.[41]

There are also road projects underway. Indeed, the share of road transport is increasing, especially for shorter distances and intra-regional trade. Road transport is particularly important in Kyrgyzstan and Tajikistan due to the limited rail networks of these countries, and road transport is sometimes the only option due to topographical factors. Road transport is also favored for time-sensitive items.

Commendable efforts have also been made by the World Bank, in particular, to improve road connectivity and transport. The Central Asia Road Links (CARs) program is one of many examples that could be cited for striving to increase transport connectivity between neighboring countries in Central Asia along priority cross-border road links. The program has particularly focused on transport connectivity between Kyrgyzstan and Tajikistan.[42]

The U.S. New Silk Road Initiative

The United States' "New Silk Road" initiative was launched in July 2011, in a speech by Secretary of State Hillary Clinton in Chennai, India. The concept, borrowed from studies and analyses carried out largely by independent researchers, including those involved with this paper, was simple and powerful: to release the potential of Afghanistan's economy by reestablishing its age-old status as a "roundabout" between routes leading west to the Middle East and Europe, north to Central Asia, and east to the Indus Valley; that is, Pakistan, India, and Bangladesh.[43]

A cursory look at a map and the briefest review of history indicates that this called for both hard and soft infrastructure that did not exist, and at the same

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[41] Rastog and Arvis, *Eurasian Connection*.

[42] Ibid.

[43] S. Frederick Starr, ed., *The New Silk Roads: Transport and Trade in Greater Central Asia* (Washington, D.C.: Central Asia-Caucasus Institute & Silk Road Studies Program, 2007), http://silkroadstudies.org/publications/silkroad-papers-and-monographs/item/13125.

time demanded diplomatic efforts to resolve decades-old border tensions that were preventing trade. Neither of these were forthcoming. In spite of the potential of the New Silk Road concept, the office charged with implementing it was staffed with retirees and junior officers and was never given the budget needed to carry out its mission, let alone to finance key projects. After Clinton delivered her Chennai speech, she never again mentioned the New Silk Road in a public address, nor did the President or National Security Advisor. Critics began to ask whether the New Silk Road was not simply the convenient cover for a U.S. departure from Afghanistan.

Notwithstanding these factors, the NSR lent timely U.S. support to the transport of electricity from Kyrgyzstan and Tajikistan to Pakistan via Afghanistan (the CASA 1000 project, managed by the World Bank), and pushed for another key project, the development of a gas pipeline from Turkmenistan via Afghanistan to Pakistan and India. After nearly two decades of delay, this TAPI initiative now appears to be moving forward, this time under Turkmen leadership. The NSR also managed to convene manufacturers and traders from Central Asia, Afghanistan, and Pakistan in an effort to promote private sector initiatives on a regional basis.

Multilateral Initiatives: The ADB's CAREC Program

Several multilateral initiatives have been launched to promote overland links through Central Asia, among which the ADB's Central Asia Regional Economic Cooperation program (CAREC) is perhaps the most noteworthy and successful to date. Launched in 1997, CAREC has so far funded 136 projects worth approximately $21 billion, most of which are related to transport, energy, and trade. $7.5 billion has been financed by the ADB, $4.5 billion by regional governments them-

selves, and $9.4 billion by the EBRD, UNDP, WB, IMF, and the Islamic Development Bank.[44] Between 2005 and 2010, the EBRD provided around $770 million in loans and grants to CAREC in the areas of transport, trade, and energy.[45]

CAREC has invested in six main corridors, stretching both east-west and north-south, totaling 4,000km (2,500mi) of new roads, 3,200km (2,000mi) of new railways, and 2,400km (1,500mi) of transmission lines. These include the reconstruction of Afghanistan's ring road linking Kabul and Kandahar with Mazar-e-Sharif and Herat. The North-South Corridor connecting Central Asia with Pakistan's ports of Karachi and Gwadar has also been prioritized, although nothing concrete has been done to implement it. CAREC also supported a new rail line connecting Mazar-e-Sharif with Uzbekistan, which will link Afghanistan with the rest of Central Asia.

In CAREC's assessment, these investments have cut transportation time by 50 percent along the new corridors. However, by 2020 an additional $50 billion is required to complete the six corridors, improve energy security, and promote new corridors. The EU has reportedly expressed interest in taking a more active part in CAREC, but member countries strive to keep external powers out.[46] Hence, the European contribution is mainly limited to the provision of funds through the EBRD.

On the negative side of the ledger, CAREC has failed to acknowledge, let alone act upon, the importance of trade with the fast-growing markets of India, Pakistan, and Bangladesh. Indeed, India and Bangladesh are not even members of the program. Nor has CAREC embraced the importance of east-west land transport between India, Pakistan, and Europe via Afghanistan and Turkmenistan. Hope-

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[44] See Craig Steffensen's remarks at the CSCE hearing, "The New Silk Road Strategy: Implications for Economic Development in Central Asia," http://www.csce.gov/index.cfm?FuseAction=ContentRecords.ViewTranscript&ContentRecord_id=546&ContentType=H,B&ContentRecordType=B

[45] See the CAREC program website: http://www.carecprogram.org/index.php?page=european-bank-for-reconstruction-and-development

[46] See Craig Steffensen's remarks at the CSCE hearing.

fully, if the TAPI pipeline moves forward, it will pull these other important projects in its wake. As will be seen below, all bear directly on both Central Asia and Europe.

The Regional Economic Cooperation Conference on Afghanistan

A further initiative is RECCA (Regional Economic Cooperation Conference on Afghanistan), which seeks to develop an Afghan-led regional cooperation process for Central and South Asia. Created in 2005, RECCA sought to help coordinate and harmonize regional cooperation projects, including in the emerging field of transport. RECCA summits have been held in Kabul, New Delhi, Islamabad, Istanbul, and Dushanbe; in 2015, after a three-year hiatus, RECCA met again in Kabul, this time under the reinvigorated leadership of the new Afghan government. RECCA-VI sought to take stock of progress since the first RECCA summit, and, more importantly, worked to *prioritize* among the large collection of projects to expand transport and trade that have been floating around without coordination or prioritization. RECCA's role is to bring together a powerful circle of countries that recognize the centrality of the southern flank of the continental transport system. As such, it is the most credible regionally based organization for the prioritization of trade and transport projects that involve Afghanistan. The success of RECCA-VI will be important in ensuring that regional voices are in the driver's seat in a process where large foreign interests are competing. Since it links Kazakhstan and Central Asia with what might be called the emerging Southern Corridor extending across the south of Eurasia, it is of direct significance to both Kazakhstan and the European Union.

China's Silk Road Economic Belt

As the trade data cited above indicates, China has strengthened its foothold in Central Asia over the past decade, a foothold that is gradually extending as far as the South Caucasus and Central and Eastern Europe. This has translated into a growing network of infrastructural links (pipelines, railroads, and roads) which ties the rest of the continent to western China.

China's western development program has been a major driver for this engagement. Most of China's industrial output has traditionally come from its eastern and south-eastern provinces, but today, growth in China's central provinces (e.g. Shaanxi, Sichuan, Guizhou) and the far-western provinces of Xinjiang, Tibet, and Qinghai is higher. In 2014, Xinjiang's economic growth reached 10% and Tibet's 12%, compared to the mean growth rate in the coastal provinces of about 6-8%.[47] Xinjiang's GDP per capita (PPP) of $11,220 in 2014 is today on a par with that of Tunisia or Egypt.

Beijing is in the process of building a $23 billion railroad from Lanzhou to Urumqi aimed at cementing relations between China's east and west, with plans to extend it through Central Asia and further on to Iran, Turkey, and Bulgaria.[48] Such new railway arteries have been accompanied by major investments in Xinjiang's road and railway infrastructure. China plans to invest $46 billion in Xinjiang's infrastructure by 2020, including 8,000 km (5000 mi) of new railroad tracks. Between 2009 and 2013, China invested around $18 billion in Xinjiang's roads alone. Furthermore, China has connected Xinjiang to the former Soviet railway lines, and major railway infrastructure is being completed into Kazakhstan and Kyrgyzstan. For example, railway projects plan to connect Kashi (Kashgar) to Kyrgyzstan and Uzbekistan, with the Kyrgyz link connecting through Tajikistan onward to Iran. Special border zones are also being created, for example in Khorgos, Kashgar, and Huoerguosi.[49]

These projects, if realized, will undoubtedly present opportunities for THE Central Asian states, in the form of expanded commercial ties with neighboring Chinese provinces and expanded potential to conduct overland trade to and from Europe. A railway corridor from Chongqing via Xinjiang to Duisburg opened in

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[47] Timothy Nixon, "China: An Opportunity for Sustainable Growth and Leadership," *Thomson Reuters Blog*, March 17, 2015. http://blog.thomsonreuters.com/index.php/tag/growth/.

[48] Simon Denyer, "Bullet Trains Tighten China's Embrace of Restive Xinjiang," *The Washington Post*, September 10, 2014, https://www.washingtonpost.com/world/with-bullet-trains-as-a-new-silk-road-china-tightens-embrace-of-its-restless-west/2014/09/10/3f24f58d-0c22-467d-84e4-e3cbc269433c_story.html

[49] Rastog and Arvis, *Eurasian Connection*.

2012, passing though Kazakhstan, Russia, and Belarus. Apart from Central Asia, other countries en route are seeking to capitalize on the emerging possibilities of overland trade. Poland, for example, established the Lodz-Chengdu and Suzhou-Warsaw railway connections in 2013.

It is necessary to note that all these initiatives assume that social peace will prevail in China's multi-ethnic Xinjiang Uyghur Autonomous Region. They are built on the assumption that the combination of economic rewards and state pressure will cause the nine-million Turkic peoples of that province to cast their lot with China and the region. The important question of whether such optimism is warranted lies beyond the scope of this study. However, alternative future scenarios on this development must be factored into any long-term Kazakhstani or European analyses of Eurasian transport.

China's most ambitious initiative to date to formalize its trade and transport engagement with Eurasia is the "Silk Road Economic Belt," which is part of the "One Belt One Road" campaign launched in late 2013. This program aims to boost connectivity and infrastructural ties between China and 65 countries. Part of China's Western Development program and "Going Global" policy, the ambition is to further promote development in China's far-western provinces, reduce the vulnerability of the transport artery through the Malacca Straits, and increase connections with the EU, the main destination for Chinese exports.

As a sign of the seriousness of this program, Beijing also plans to sponsor links *within* Europe, for example the Budapest-Belgrade high speed rail and the Budapest-Piraeus link.[50] According to one study, the lion's share of China's recent overseas lending pledges have been to countries located along the "Silk Road Economic Belt." Seventy-six percent of the loan commitments, a total of $49.4 billion, have been extended to Eurasian countries along the Silk Road since its launch.[51]

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[50] European Commission, "China's Transport Diplomacy," June 19, 2014, http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=15033&no=4.

[51] James Kynge, "Chinese Overseas Lending Dominated by One Belt, One Road Strategy," *Financial Times*, June 18, 2015.

In 2015, Hungary became the first European country to sign a cooperation agreement with China's Silk Road Economic Belt,[52] and the EU is about to align its own projects with the program. At the same time, EU representatives have expressed a desire to prevent this from becoming overly Sino-centric and to "level the playing field."[53] Similar ambitions have been expressed by India, which has matched China by launching its own Silk Road Fund, albeit for now with a considerably smaller budget.[54]

[52] "Hungary First European Country to Sign up for China Silk Road Plan," *Reuters*, June 6, 2015.
[53] European Commission, *China's Transport Diplomacy*.
[54] Vrishti Beniwal and Natalie Obiko Pearson, "Modi Follows China with Proposal to Expand Loans across Asia," *Bloomberg Business*, April 21, 2015.

Four Challenges for the European Union and Central Asia

The prospect of reopening age-old corridors of transport and trade has generated justified enthusiasm in East and West. One must, of course, be wary of the old adage that "trade builds peace." After all, Germany and Russia were each the other's main trading partner on the eve of World War II. Yet in addition to benefiting both Europe and China, such trade has the potential to facilitate the urgently needed diversification of the economies of Central Asian transit states. Moreover, it will broaden and deepen their international contacts in fields far beyond transport and manufacturing, and strengthen Europe's appreciation of the benefits to be gained through closer economic and cultural ties with Kazakhstan and its neighbors.

Indeed, from a European perspective, the role of Kazakhstan stands out in terms of transport and trade. To be sure, Kazakhstan is not the only country to have a crucial role in the developing transport infrastructure. Being centrally located and bordering every Central Asian country including Afghanistan, Uzbekistan also has considerable potential. And for future links between Europe and South Asia, Turkmenistan is also centrally located. Yet as European leaders consider the expansion of trade and transportation links, Kazakhstan occupies a unique position in at least three ways. First, by virtue of geography, Kazakhstan forms a one-country link between China and the Caspian Sea, ensuring it will play a dominant role in any land links between Europe and China. Second, Kazakhstan is the Central Asian country that has gone the farthest in terms of deepening institutional cooperation with the EU, as evidenced by the signing of an enhanced EU-Kazakhstan Partnership and Cooperation Agreement in 2015. Third, in a regional context Kazakhstan offers an improving business environment crucial to the establishment of a trading hub: In the World Bank's Doing Business 2016 ranking, Kazakhstan jumped 12 positions from 53rd the previous year up to 41st. Thus, if the EU

were to take a more strategic approach to continental transport and trade, it will be natural to focus initially on the partnership with Kazakhstan. Importantly, however, this should not occur at the expense of a focus on other regional countries, but as a first step in what must ultimately be a regional effort that includes all Central Asian states, including Afghanistan.

The heady potential has fed the prevailing enthusiasm, but it has also caused all parties involved to underestimate the challenges that must be addressed before such potential can be achieved. The authors of this study fully share the excitement evoked by the prospect of re-opened trade corridors between Europe and Asia. Over several decades, they have worked to advance the cause of continental transport through Central Asia. But precisely because they support the concept, they believe it imperative for all parties to approach the project with a sober acknowledgment of the several challenges that must be faced and overcome before its benefits will be reaped. In the following pages we will identify and address the four challenges we consider most urgent and consequential:

- The program thus far has been dominated by governmental initiatives. But future success will be determined as much or more by market realities, and will depend on the private sector. Therefore, the first challenge is to embrace and build upon the inevitable shift from activities initiated and funded by governments to market-driven activities in many spheres, which must exist for the project as a whole to succeed.
- To now, virtually all discussion of the New Silk Road has focused on the roles of China and the European Union. But for the project to succeed, it will be necessary to develop "soft infrastructures" along the route itself. Given its location and its status as the largest transit country between Europe and China, Kazakhstan is a likely and suitable locus for such activities, which should be developed both by Kazakhstan-based businesses and by Kazakhstan-Europe partnerships in many fields. The development of such businesses will benefit shippers in the East and West and at the same time be essential to garnering the local support within Kazakhstan, which will be instrumental if the New Silk Road is to be sustainable.

- The geopolitics of transport and trade must be fully understood and their importance acknowledged by clear-headed policies. It is in the interest of both Europe and Central Asia to ensure that no power gains the ability to monopolize or control the emerging East-West transport corridors. This means utilizing the existing road and rail links to Northern Europe via the Russian Federation. But it also calls for balancing that route with the emerging corridor to Europe via the Caucasus and Turkey. Failure to achieve such balance will imperil the success of the entire project.
- To assure that both present and future phases of the project are informed by the insights to be gained from the analysis of longer-term developments on the Eurasian continent, and specifically the likely rise of the Indian sub-continent as a major economic force by the year 2040. Acknowledging this emerging reality, the European Union, Kazakhstan, and other Central Asian states should combine forces to advance the opening of the most direct and efficient transit corridors between Kazakhstan, Central Asia, and the Indian sub-continent. These should be understood as an essential but separate supplement to the Silk Road Corridor, and their creation should be a task for the transit countries themselves.

It is necessary to amplify these telegraphic points and to spell out their implications for both Central Asia and the European Union as they engage together in the New Silk Road project.

From Government to Market

The efforts to promote Eurasian trade routes have been dominated by governmental programs, as is understandable with infrastructure. However, it is clear that henceforth the progress of the initiatives will increasingly be determined by market realities.

The key question is whether shippers in the EU, the Middle East, and Asia will choose to use the infrastructure that governments have helped provide. The development of land routes is occurring at a time when ships are going back and forth between Europe and Asia partially empty. There is at present an oversupply

of ships; given this, and the plunge in energy prices, the price of water transport is likely to decline. Moreover, new technology holds the potential for more on-the-spot production, as is the case in 3D printing. This may make it more attractive for some industries to produce certain goods on site rather than sourcing them from faraway continents. Therefore, the building of trade links in Europe and Central Asia should focus not just on the completion of TRACECA, which is a given but, more importantly, on making these transit routes attractive from a market standpoint.

The program will rise and fall on the basis of soft infrastructure, which depends solely on the private sector. This means that governments have to focus on easing the crossing of borders, implementing low or at least competitive tariffs, as well as providing frameworks that ensure the quick and fair resolution of disputes arising from shipping. In sum, the task will be to focus on the market and make trade routes both predictable and attractive to businesses near and far.

"Soft Infrastructure"

Enthusiasm for the construction of "hard infrastructure," i.e., railroad lines and paved roads connecting China and the European Union, has relegated all other forms of infrastructure to a secondary status. This is unfortunate and potentially dangerous. The world is littered with grand infrastructure projects that failed due to the postponement or non-existence of the supporting institutions that are essential to their functioning. The widely quoted phrase "Build a road (or railroad) and people will use it" is simply wrong. They are just as likely to ignore it.

"Soft infrastructure" takes many forms. The most obvious is the structure of tariffs imposed on shippers using a given railroad or road. These are regulated to some extent by international agreements but they are also subject to the sovereign will of the transited country, in this case Kazakhstan and other Central Asian states. The case for low tariffs is obvious, for without them shippers will turn to more competitive routes. But if they are too low, citizens of the transited country will object, claiming that their territory is being used by others, without adequate payments to them. Reasonable and firm agreements between the EU and Kazakh-

stan can prevent this from happening. Such agreements must involve all interested countries and parties and must be solidly endorsed by the private sector as well. Unilateral control by any one party can lead to misunderstandings and the suspension of trade along the given route.

A second and no less important dimension of "soft infrastructure" pertains to private firms in such fields as freight forwarding, logistics, insurance, storage, supplies and equipment maintenance, and hotels. Each of these is important. Indeed, the absence of any one of them could break the chain of institutions necessary for the smooth functioning of an international trade corridor.

To date, there has been little, if any, serious discussion of these crucial issues. Even though private firms in many countries have quietly carried out their own analyses of the needs and prospects, there exists no major study by either European or Central Asian experts on how to encourage the establishment of the network of companies and industries as a whole. Such studies need not, and should not, be carried out in the spirit of top-down planning. Rather, they should seek to identify the *impediments* that will inhibit the free development of private initiatives in each of these areas. Such impediments may arise from national legislation, permit requirements, overly restrictive labor laws, taxation of essential imported equipment, or controls on the repatriation of earnings. The first task of policy must be to identify all such barriers to the development of soft infrastructure in each of the areas listed above and to lead a systematic process to alleviate them.

A further focus of future policy is no less important than the removal of impediments to the establishment and functioning of firms in these areas. First, effective measures must be taken to ensure that a key node is created along the China-Europe route for firms in all the key areas of soft infrastructure, e.g. freight forwarding, logistics, insurance, storage, supplies and equipment maintenance, and hotels. A glance at the map, as well as the country's economic situation, shows that Kazakhstan is ideally situated to serve as a hub for these services. But geography is *not* destiny. Any of a hundred impediments can neutralize the potential benefits Kazakhstan should derive from its location.

In spite of Kazakhstan's current laudable efforts to diversify its economy, and while it may have a more beneficial climate for doing business than its neighbors, the country does not presently offer market-friendly conditions to host firms in all these areas. Still less is it able to generate firms of its own that will be able to successfully compete with the international giants that will inevitably appear on the scene. Restrictive regulations, bureaucratic lethargy, and outright corruption are the chief villains. Without a firm hand from the Government of Kazakhstan, backed up by clear and effective support from the EU, Kazakhstan will be doomed to the status of a passive transit country and not an active participant in the new continental economy and a beneficiary of its fruits.

To remedy these problems, Kazakhstan's government and private sector should reach out to European firms in all fields of logistics to accomplish two goals: first, to have them base their Central Eurasian operations in Kazakhstan and, second, to work with Astana to create Kazakh-managed entities locally. In other words, the goal should be to strengthen Kazakhstan's public and private sector in all the relevant fields of soft infrastructure. Since nearly all of Eurasia's leading logistics firms are European (mainly German, Swiss, and Danish), it would be possible within the framework of Kazakhstan's outreach to the EU to mount a systematic program to build Kazakhstan's capacity in the area of soft infrastructure to a world-class level. Once this is realized, it is more likely than not that such success will nudge Kazakhstan's neighbors toward emulating the reforms that were needed for this to be realized.

A recent Kazakh initiative is relevant in this regard: the Astana International Financial Center, modeled on the equivalent center in Dubai, which was announced in July 2015. Confirmed by the Kazakhstani senate in November 2015, the AIFC will be lodged on the grounds of the EXPO 2017 in Astana, be based on British law, and will have a special tax, currency, and visa regime to attract foreign personnel.[55] To establish Astana as a financial center, the AIFC will essentially oper-

[55] Senate OKs Constitution Law on International Financial Center in Astana", Kazinform, November 5, 2015. (http://www.inform.kz/eng/article/2836038)

ate under its own legal regime, derogated from national law; the operating language the center's administration and its court system will be English, with an international arbitration center expected to include foreign judges and arbitrators.[56] Clearly, this initiative, if realized, will go a long way toward encouraging the type of investments in soft infrastructure that will be crucial for the development of the transport sector, and on this basis, further specific initiatives in the transport sector should be considered.

The Geopolitics of Trade

Once goods have crossed the Sino-Kazakh border at Dostyk and entered Kazakhstan by road or rail, two options for further transport to Europe present themselves. First, a northerly route to Northern Europe via Russia and Belarus; and second, a southerly route to Central and Southern Europe that crosses Kazakhstan to Aqtau (or, alternatively, across Uzbekistan and Turkmenistan to Turkmenbashi) and then connects by ship to the newly built port of Alat near Baku, which is in turn connected via road or the Baku-Tbilisi-Kars railway to other railroad lines or highways to Europe or the Middle East.

The northern route via Russia was developed largely during the Soviet era, but now takes advantage of Kazakhstan's membership in the Eurasian Economic Union. Naturally, Russia would prefer that as much freight from China to Europe passes via its rail and road systems. Indeed, Russia would prefer for China to forgo a route through Kazakhstan and instead channel all its shipments to Europe northward and thence via the Trans-Siberian Railroad to Europe. When China made clear it wanted new routes that would run through its Xinjiang province and generate benefits for its restive Turkic and Muslim population, Russia then pushed hard for an alternative route to Europe that ran westward to Urumqi and then through Russia's Altai mountains to connect with the Trans-Siberian Railroad east of Novosibirsk. This route, too, failed to materialize when China rejected it and a coalition of Russian environmentalists opposed it at home. Russia

[56] Adam Kaucher, "Creation of Astana International Financial Center", *Dentons*.com, September 11, 2015. (http://www.dentons.com/en/insights/articles/2015/september/11/creation-of-astana-international-financial-centre)

still seeks to garner as much of China's western trade as possible, and has therefore fallen back to champion its rail link between western Kazakhstan and Europe.

This route has much to commend it, and must surely figure in long-term thinking in both Kazakhstan and Europe. However, it is not in the interest of Kazakhstan, other Central Asian states, Europe, or China to allow a single Russian route to dominate or monopolize traffic along the main East-West Corridor. The existence of a second route will discourage Russia from using access to its corridor as a tool for exerting influence over the other shipping or transit countries. To be sure, officials of the Russian railroad system have assured that this will not be done, and justifiably point to their successful participation in the Afghanistan war era Northern Distribution Network (NDN) connecting Afghanistan with the Latvian port of Riga as evidence of their good record in this regard. Yet world politics have changed since the heyday of the NDN, and the possibility of Russia engaging in politically motivated interference in European transport systems is more than theoretical. During the years when Russian pipelines were Europe's main source of gas, Russia successfully played the "gas card" against Europe, restricting supply and raising costs whenever it wanted to drive home its position on a policy issue involving Europe. Ukraine, as a transit country, was even more vulnerable to such maneuvers by Moscow, and Russia's political use of its energy monopoly vis-à-vis former Soviet republics is well-documented. Over time, Europe responded by seeking to diversify its sources of gas.

A Russian veto over land trade between China and Europe would provide the opportunity for Moscow to do in road and rail transport what it has already done in the sphere of energy. Such an eventuality could be disastrous to all parties involved, including Kazakhstan and Russia itself. To prevent such, a second route from western Kazakhstan to Europe must be developed. Fortunately, such an alternative is well on the way to completion, in the form of the emerging transit corridor to the West running from Baku in Azerbaijan via Georgia and Turkey to the Black Sea and the Mediterranean basin.

Barely had dust settled from the collapse of the USSR when Europe perceived the importance of the Caucasus corridor and created its TRACECA program to develop it. Financed initially by the European Union but later mainly by local sources in the three main transit countries and by international energy firms, the Caucasus corridor is fated to become a kind of "Land Suez." As such, it will reinforce the sovereignty and security of Azerbaijan and Georgia, for even the most powerful external countries would have to think twice before attacking a transit corridor used by all the main economies on the Eurasian landmass.

In the past several years, the opportunities for transit across the Caspian Sea have increased considerably. Kazakhstan itself has developed the port of Aqtau; Turkmenistan has upgraded the port at Turkmenbashi; and Azerbaijan has built a major new port facility at Alat, south of Baku. Together, these three states have invested tens of billions of dollars in port development. Adding to this are the newly expanded Georgian ports of Poti and Batumi, and the projected port of Anaklia.

These developments dovetail with the strengthening of rail networks connecting the western Caspian shore with Europe. Primary among these is the Baku-Tbilisi-Kars railroad, which will connect the Azerbaijani and Georgian railroads directly to the Turkish rail network; and the Marmaray project, which is digging a tunnel beneath the Bosporus that will connect the European and Asian sections of the Turkish railroad system. When these two projects are completed, a high-capacity railroad link from the shores of the Caspian to the European Union will be operational. Furthermore, the existing railroad connections to Georgia's Black Sea coast provide the opportunity to develop the maritime linkages to the Central and East European railroad system, particularly the Viking Railroad.

The Viking Railroad, forming a Baltic-Black Sea link, connects Lithuania with Ukraine via Belarus. The project's core runs from Klaipeda in Lithuania via Belarus to the Ukrainian port of Illichivsk near Odessa on the Black Sea—a 1776km (1100mi) run over 52 hours—but its full stretch extends from the United Kingdom to China. Starting in Great Britain, cargo is transported by DFDS Seaways to Gothenburg in Sweden where it links with a cross-country railroad hauling containers to the port of Karlshamn on the Baltic Sea. After arriving by sea to the port

of Klaipeda, containers are forwarded via the Viking Railroad to Illichivsk on the Black Sea and thence to either Turkey or Georgia. The Turkey spur extends southward towards the Middle East while the Georgian port of Batumi links the project to onward connections in Armenia and Azerbaijan. From Baku, freight is shipped across the Caspian Sea to Almaty, close to the Chinese border. Once in China, cargo is loaded onto the East-West railroad connecting western China with the booming coastal cities of Shanghai and Beijing.[57]

In other words, for trading partners in the East, the Caucasus corridor is an important access route not only to Southern Europe, but to the Baltic region as well. For Kazakhstan and its Central Asian neighbors, investing in the Caucasus corridor helps to anchor the sovereignty and independence of Georgia and Azerbaijan, and will help prevent larger neighbors to the north or south from taking actions that have a destabilizing effect on the entire region, including Kazakhstan itself.

Aside from the security that alternative routes bring, a further reason for supporting the Caucasus route is competition. The existence of two separate rail connections linking the Dostyk border crossing with the major industrial centers of both Northern and Southern Europe creates a powerful incentive to drive down cost, which will further stimulate traffic in both directions.

What must Europe, Kazakhstan, and other Central Asian states do to ensure the openness and viability of both the northern corridor across Russia and the Caucasus corridor and their access to it? We will leave to Kazakhstani and Azerbaijani engineers the seemingly utopian possibility of a bridge connecting Aqtau and Baku. Meanwhile, the European Union, China, and Kazakhstan must actively engage with Russia to develop a firm regimen that protects the free movement of trains and trucks across the northern corridor, of ships moving between the three main Caspian ports of Aqtau, Baku, and Turkmenbashi, and of trains and trucks across the Caucasus.

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[57] Nicklas Norling, "Viking Railroad Connects Scandinavia with South Caucasus, Central Asia, and China," *Central Asia-Caucasus Analyst*, November 2, 2011, http://cacianalyst.org/publications/analytical-articles/item/12384.

The United States should also be prepared to participate in such arrangements if necessary; as should Iran, as both a Caspian state and neighbor of Azerbaijan and Turkmenistan. In light of the growing militarization of the Caspian by several states, these arrangements must be reinforced by agreed-upon sanctions and penalties in the event they are broken. All participants in such talks must be considered equal partners, with no one of them able to veto arrangements affecting the transit of goods in both directions across Eurasia. Overall, we consider such an agreement to be the essential keystone for the entire enterprise.

Second, the European Union, China, Kazakhstan, Turkmenistan, and Uzbekistan must be in constant contact with Azerbaijan, Georgia, and Turkey to monitor and hasten the development of that corridor. And, third, the EU, China, and the Central Asian states must be prepared to channel significant trade through the Caucasus (Southern Corridor) for an agreed period of time in order to help pay back the enormous investments made by Azerbaijan, Georgia, and Turkey in that route.

Looking Forward: The Indian Subcontinent

To this point, our analysis has focused on the new transport corridors that will link Europe with China via Kazakhstan and Central Asia. This is as it should be, given the extraordinary growth of Chinese manufacturing over the past three decades, and the increasing demand of China's rapidly expanding consumer market for procuring manufactured goods from Europe and Europe's interest in providing them. However, it was long impossible for either party to trade with the other by land without submitting to the direct control of a third party, the USSR. Only the collapse of the Soviet Union opened up the possibility of such direct trade by land, using the direct corridor provided by the newly independent state of Kazakhstan. Accordingly, China, with the concurrence of the Kazakhstan government, turned to the Asian Development Bank to develop railroad and road routes across Kazakhstan towards Europe. Meanwhile, Europe's TRACECA project offered the prospect of linking these new routes directly to Europe via the Caucasus, where the European Union, Turkey, Azerbaijan, and Georgia combined

forces to provide swift rail and road connections between Baku and Europe. Russia meanwhile offered its territory as another direct link between Kazakhstan and Western Europe.

Viewed against this background, China's Silk Road Economic Belt and the European Union's newly reinvigorated TRACECA program can be seen as important and coordinated efforts to solve a problem in continental transport that has existed for decades and grown steadily in urgency. Kazakhstan's central role in both projects offers the prospect of an important step towards diversifying what has been to now an extraction-based economy. The same will prove true for Turkmenistan.

Sound planning requires that at this point we ask whether the trans-Central Asia routes between China and Europe will continue to expand in importance at the same pace as heretofore. This will depend on at least three factors: first, the likely rate of growth of China-Europe trade in the coming decades; second, the percentage of that trade that is carried by railroad and road, as opposed to ships; and, third, the likelihood of other major centers of manufacturing and trade emerging in Asia in the coming decades that will not necessarily rely on the China-Europe corridor via Central Asia.

In spite of the current slump, most economists project that the Chinese manufacturing sector will remain strong in the coming decades (even though its exceptionally high rate of growth in recent decades has already begun to decline). They also stress the growth of China's own consumer market, which will claim an ever-increasing percentage of China's total manufacturing output. This suggests that the importance of land routes to Europe may eventually level off. Balancing this is the near-certain prospect that Europe will export more to China in the coming decades.

As we have seen above, the percentage of this trade that passes through Central Asia will depend in part on the speed, cost, quality of "soft" trade infrastructure, and security of the Central Asian routes. It will also depend on the cost of shipment by sea, adjusting for the time factor. As noted above, the present huge overcapacity of ships plying between China and Europe suggests that the cost of using

sea-lanes may decline in the coming years, posing a competitive challenge to the land corridors.[58] A final caution arises from the fact that both Chinese and European manufacturers are seeking to expand production in the other's countries. To the extent this occurs, the shipping of completed manufactured goods will level off at some point, if it does not actually decline.

These considerations strengthen the hypothesis that China's Silk Road Economic Belt addresses transport problems that emerged and persisted over the past decades but that it will face a series of practical constraints in the coming era. This does not question that there will be an impressive burst of new Europe-China traffic as soon as the new corridors are inaugurated and are fully functioning. But it suggests that at some point in the not too distant future this activity will even out, and even face renewed competition from the sea and air lanes.

Let us now turn to the question posed above: is it likely that manufacturing by other countries or regions in Asia is likely to undergo the same kind of boom that China has experienced over the past generation? If so, is it not likely that these countries will be no less interested than China in reaching the European market, and that they will not necessarily view the New Silk Road network, as presently conceived, as serving their best economic interests?

In addressing these vital questions, it is important to specify the timeframe in which our responses are to be set. We are definitely *not* speaking about the next five years, or even the next decade. Rather, let us take a longer-term and more *strategic* view. This requires us to look ahead at least to the year 2040 and even 2050. A skeptic might argue that projecting this far ahead is nearly impossible, given the number and importance of variables, "known unknowns," and "unknown unknowns" that could force their way to the fore. Reality confirms that this criticism is fully justified. However, the one projection that we can make with near-certainty is demography. The reason for this is simple: most of those who

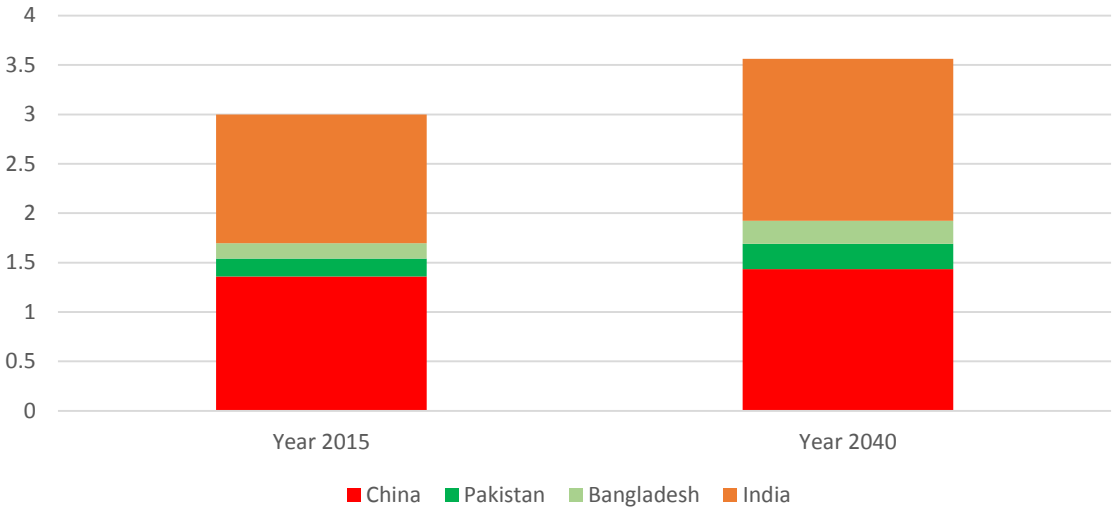
[58] Erica E. Phillips, "Container Ship Operators Face 'Overcapacity Crisis,' Report Says," *The Wall Street Journal*, October 8, 2015, http://www.wsj.com/articles/container-ship-operators-face-overcapacity-crisis-report-says-1444329882.

will comprise the adult population of Asian societies have already been born. In other words, we know who they are and where they are.

Demography tells us that there are two realities of the year 2040 that are of overwhelming importance to the future of European trade with Asia and the potential role of Central Asia, particularly Kazakhstan, Uzbekistan, and Turkmenistan in such trade. First, we can be absolutely sure that by our target years the population of the Indian subcontinent will be nearly half again larger than that of China and, second, that India's population will be much younger than that of China. Both of these statements require further explication.

Demographers have long acknowledged India's inevitable emergence as the world's most populous country and have closely analyzed its progress towards that status. However, discussions of its economic significance have nearly all ignored a vitally important corollary, namely that India's two main neighbors, Pakistan and Bangladesh, both exhibit similar rates of population growth. Whereas China's current population of 1.36 billion exceeds India's 1.3 billion, it is far less than the combined population of India, Pakistan, and Bangladesh, which already stands at 1.65 billion. By 2040 China's population is expected to reach 1.435 billion but India will top 1.640 billion, Pakistan 254 million, and Bangladesh 235 million. This will make for a combined total population in the Indian subcontinent of 2.129 billion.

Figure 8: Chinese and South Asian populations 2015-2040, bln



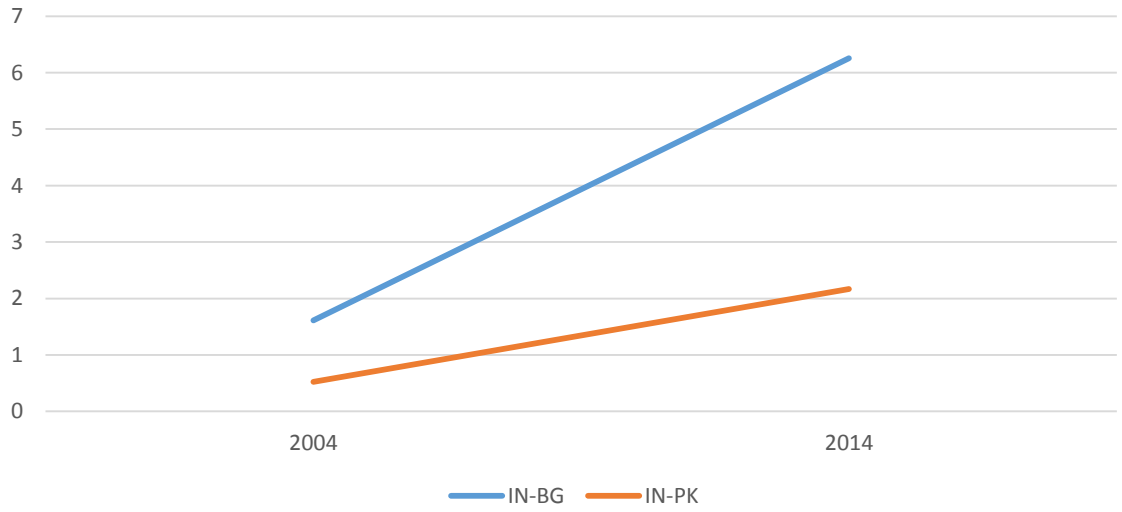
How, if at all, are these figures relevant to our enquiry, especially in light of the poor state of relations between these three countries over the past generation? On that basis, there are few grounds for considering their economies together, let alone as a single economic unit. Yet this is not the whole story. Indian exports to Bangladesh were a mere $1.3 billion in 2004, but the rate of growth is now 9% annually. Moreover, this accounts only for documented trade, whereas the sum of undocumented trade in both directions is many times larger. The participation of both countries since 2006 in the South Asia Free Trade Area opens a door to great expansions of trade in the future.[59]

The same picture exists with respect to India and Pakistan. Whereas official data refers only to $1.97 billion of trade between the two countries, unofficial estimates range upward to $5 billion per annum. It is no secret that Pakistan's military opposes this trade but it now extends to such diverse fields as electronics, fruits and

[59] World Bank, "India-Bangladesh Bilateral Trade and Potential Free Trade Agreement: Main Report," *Bangladesh Development Series* 13 (Washington, D.C.: World Bank Group, 2006).

vegetables, textiles, and even healthcare. Estimates of the potential for India-Pakistan trade put the figure at $19.8 billion per annum.[60] India's Prime Minister Narendra Modi fully recognizes this, and began his tenure by working to expand trade and transport with Bangladesh and Southeast Asia. Powerful Pakistani industrialists are similarly aware of the potential and are seeking means of breaking the current stalemate on official trade.

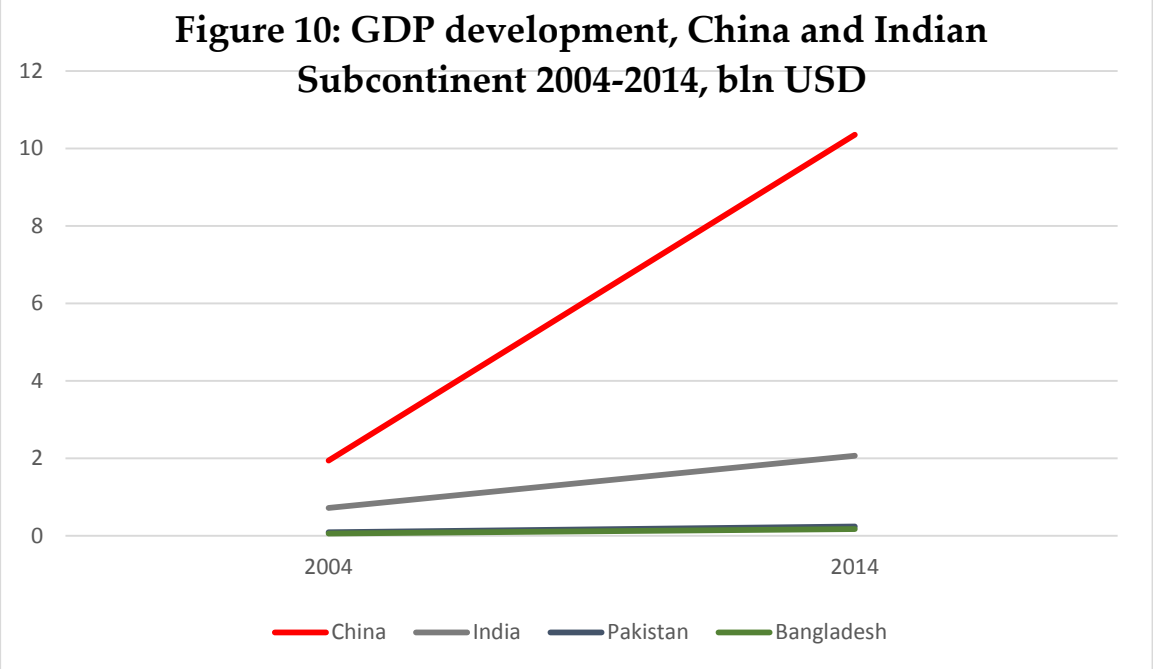
Figure 9: India-Pakistan, India-Bangladesh annual total trade, bln USD



It is impossible to predict the future, but politically significant pressure groups in all three countries embrace the potential to be reaped from a breakthrough, making it far more likely in the coming decades than in the past. Even without such a breakthrough, all three economies are thriving, with India's slow-but-steady economic growth providing a driver and impetus for cooperation. And even without such coordination, these are three large societies with important manufacturing sectors that are eager to reach markets abroad, especially in Southeast Asia, the Middle East, and the West. The growth of India's GDP for the first half of 2015 is

[60] Vaqar Ahmed et al., "Informal Flow of Merchandise from India to Pakistan: The Case of Pakistan," *SDPI Working Paper* 141 (Islamabad, Pakistan: Sustainable Development Policy Institute, 2014).

1.6%, while China's is now down to 1.8%. Pakistan's growth has been more erratic, but is now over 4% per annum, while that of Bangladesh is currently at 6.5%. Any projection regarding Central Asia and Europe that ignores this reality does so at the risk of missing what could well become the single most important development in the global economy of the coming decades.



These developments bear directly on Central Asia's future transport and trade links, and also those of Europe. They suggest that with or without extensive cooperation among the three countries, the large economic zone comprising India, Bangladesh, and Pakistan is likely to become a principal driver of the world economy in the coming decades. Stated differently, it is entirely possible that these countries could together play the kind of economic role globally that China has played over the past generation. This projection assumes the continued vigorous expansion of the Chinese economy, but suggests that its relative role on the Eurasian landmass is likely to be that of one giant player among several, with the three countries comprising the Indian subcontinent emerging as its strongest Eurasian competitor in economic terms.

With this in mind, let us turn to the question of land transport between the Indian subcontinent and Europe. Two very significant realities are likely to shape the situation by 2040. First, trade between the Indian subcontinent and Europe and the Middle East is not new. Although the great routes that connected the Indian

subcontinent with Europe and the Middle East lack the colorful and evocative name of the "Silk Road" that was coined by a German scholar in the 1870s, they are much older than those connecting China with these regions. Valuable blue lapis lazuli stones from Afghanistan were traded over these routes to ancient Egypt and as far east as Myanmar as early as the third millennium BC. Not only were these routes longer than the so-called Silk Road from China, they were much less frequently interrupted than China's corridors to the West. No less significant, over the millennia they carried far more cultural goods in both directions than did the Silk Road, bearing Indian numerals to Europe (where they are mistakenly known as "Arabic" numbers), as well as the concept of zero and negative numbers. And whereas Chinese deposited their goods at their western border, where they were picked up by traders from Central Asia, Indian subcontinent traders carried their goods directly to the West, establishing Indian trading centers in all cities along the route.

The second important reality arising from this discussion of ancient transport and trade links between the Indian subcontinent and Europe is that a significant part of this commerce passed through Central Asia, and specifically through what is now Kazakhstan, Turkmenistan, and Uzbekistan. This may strike the reader as problematic. Kabul, which sits astride the main east-west route from India, lies seven hundred kilometers south of Almaty. Yet Almaty is only half as distant from New Delhi as it is from Beijing, and it has always been connected to India by several routes. Those Indian numerals reached the West through the northern and western reaches of Central Asia, not by sea. Camel caravans carrying the equivalent load of a small freight train regularly made the trip from India through Central Asia to the West. Curiously, Kazakhstan's Caspian port of Aktau, which provides the link to the Caucasus and the EU's TRACECA and is often mentioned in terms of China's Silk Road, is just the most recent version of an ancient route that started in South Asia and India. Of course, in this regard Kazakhstan and Turkmenistan will compete for this corridor, the latter being in many ways even more strategically located.

What is the relevance of these facts from the distant past for our analysis of trade and transport between Central Asia and Europe today? First, a program that focuses exclusively on the connection of China to Europe and the Middle East ignores what is potentially an equally important corridor, namely, the ancient caravan road connecting Kazakhstan, Turkmenistan, and Uzbekistan with the Indian subcontinent via Afghanistan, a route that over many centuries played a crucial role in connecting Europe and India. It is true that a route from India to Europe via Iran and the Middle East is more direct, yet tensions in the Middle East threaten to render such a route insecure for the foreseeable future, and strengthen the case for a Central Asian route. Moreover, routes from the Indian subcontinent through Central Asia and Kazakhstan are the most direct path to Northern Europe. China's Silk Road Economic Belt project has many virtues, but it in no way addresses India's growing need for a land-based trade corridor to the West. It was in recognition of this stark truth that Prime Minister Modi recently visited all the capitals of Central Asia, including Astana.

Given continuing problems in Afghanistan and ongoing tensions between India and Pakistan, the idea of a trade corridor between Central Asia and the Indian subcontinent may seem a quixotic hope. But it should be remembered that back in 1993, when China moved to open a direct corridor to Europe via Kazakhstan, that possibility seemed equally quixotic. Discussion of routes between Central Asia and South Asia did not even begin until after a coalition of NATO forces crushed the Taliban government in Afghanistan in 2001. In other words, consideration of a Europe-Central Asia-India corridor could not and did not commence until a full generation after the Europe-Kazakhstan-China corridor was launched by the EU and China. Even then it proceeded very slowly until quite recently, when the tempo picked up.

The need for a transport and trade corridor linking Central and South Asia arises not from some romantic view of the past but from sober calculations on the likely economic growth on the Indian subcontinent. A further reason for Europe to take an active role in helping Kazakhstan and its Central Asian neighbors open a trade corridor to the South is that the creation of such a corridor meshes with the foreign policy objectives of both the regional states and the European Union. In spite of

having joined the Eurasian Economic Union, Kazakhstan seeks to maintain a balanced foreign policy, with cordial and productive ties with all surrounding powers. These include India as well as Russia, China, and Europe, and will increasingly include Pakistan. For its part, the EU has always championed the sovereignty and self-determination of all the states of Central Asia. By supporting trade corridors that connect Kazakhstan with India as well as China it will significantly advance this cause.

While Central Asian states and the European Union should support China's Silk Road Economic Belt initiative, they should at the same time be planning concrete and separate measures to develop Kazakhstan's links to the Southern Corridor connecting the Indian subcontinent and the West and removing impediments to such a corridor in Afghanistan and Pakistan. With the countries of the Indian subcontinent fated by 2030 to be both a bigger market than China and larger and lower cost producers, the EU and Central Asia will ignore this reality at their peril.

Conclusions

The reopening of transport corridors connecting Europe and Asia via Central Asia is sure to be one of the most momentous developments of the coming decades. By creating land routes that will enable the booming economies of China and its neighbors to trade directly with the large economies of the European Union, it will increase the speed and drive down the cost for everyone involved. The benefit of such a development for Europe's manufacturing sector is obvious. The Central Asian transit countries also have much to gain from this project, including new hard and soft infrastructure, yields on tariffs, the creation of jobs, and efficient outlets for their own products.

Initiatives to develop these new trade corridors warrant the strong support of both the European Union and of Central Asian countries, including also Afghanistan. Because it is the locus for the two most important railroad and road routes, Kazakhstan in particular has much to gain from the new overland corridors, although Turkmenistan, Uzbekistan, Kyrgyzstan, Tajikistan, and Afghanistan will also reap substantial benefits if they play their cards wisely. But this will not happen automatically, or without carefully directed and strong governmental and private sector interventions from their side. Moreover, a development that has the potential to bolster their sovereignty and self-determination could, if managed ineffectively, end up by eroding both. It is in the interest of both the Central Asian countries and the European Union to prevent this at all cost.

This study stresses the need for close and effective coordination between the European Union and the transit countries of Central Asia. Such coordination must be based on their common interests as defined through careful analyses by both sides and by close consultation between them. Rather than define their common interests narrowly in terms of trade, the two sides should extend the inquiry into

all matters that will be affected by the opening of Eurasian land corridors, including nearly all sectors of their economies, diversification, governmental institutions, national and regional security, and demography.

The proper locus for such coordination should be the regularized consultative process that already exists between the EU and the five former Soviet countries of Central Asia, and also the EU's existing channels of interaction with Afghanistan. Ideally, the EU should bring Afghanistan into its Central Asian consultations, although it is understood that this is unlikely to happen until more peaceful conditions prevail in that country. In both cases, it would be highly desirable for the EU to propose the creation of a special entity within its consultative process with Central Asia that would focus on land transport and would recommend joint actions that are needed in that area. Since the establishment of such an entity will take time, it is recommended that the EU begin at once on a bilateral basis through its expanded Partnership and Cooperation Agreement with Kazakhstan. This is justified by the fact that Kazakhstan will become the most active transit country in the region, but a bilateral approach cannot become a substitute for the region-wide arrangements that are needed by both the EU and Central Asia.

Beyond these procedural conclusions, this study identifies four issues that the EU and Central Asian countries should take up immediately and address together. These recommendations are treated in turn below.

1. Nearly all attention regarding continental trade by land has thus far been dominated by governmental initiatives. But future success will be determined as much or more by market realities, and dependent on the private sector. **Therefore, the first challenge is to embrace and build upon the inevitable shift from activities initiated and funded by governments to those market-driven activities in many spheres that must exist for the project as a whole to succeed.**

2. To now, virtually all discussion of the New Silk Road has focused on the roles of China and the European Union. But for the project to succeed, it will be necessary to develop "soft infrastructures" along the route itself. By this we mean freight forwarding, logistics, insurance, storage, supplies and equipment

maintenance, and hotels. Given their location between Europe and China, Central Asian countries, beginning with Kazakhstan, are likely and suitable locales for such activities, which must be developed both by Central Asia-based businesses and by Central Asia-Europe partnerships in many fields. The development of such businesses in the sphere of "soft infrastructure" will benefit shippers in the East and West and at the same time be essential to garnering the local support within the Central Asian countries that will be essential if the New Silk Road is to be sustainable. **We therefore urge the EU and Central Asian countries to work together to identify and remove existing impediments to the establishment of locally based soft infrastructure and to encourage private sector firms in their countries to seize opportunities in this area.**

3. The geopolitics of transport and trade must be fully understood and their importance acknowledged by clear-headed policies. It is in the interest of both Europe and Central Asia to ensure that no power gain the ability to monopolize or control the emerging East-West transport corridor. This means utilizing the existing road and rail links to Northern Europe via the Russian Federation. But it also calls for balancing that northern route with the emerging corridor to Europe via the Caucasus and Turkey. Failure to achieve such balance will imperil the success of the entire project. **We therefore urge the European Union and its Central Asian partners to hasten the full opening of the transport corridor through the Caucasus and to facilitate its use by simplifying access through the Kazakhstani port of Aqtau and Turkmenistan's new port at Turkmenbashi. Working also with China they should enter into negotiations with Russia and Iran to assure that no Caspian littoral power has the right or power to impede such trade.**

4. Discussion and action on trans-Eurasian land corridors to date has focused almost exclusively on reconnecting China and Europe. Important as this is, it is not the only reconnection that must be effected. Looking forward, it will be necessary also to take fully into account the almost certain rise of the Indian subcontinent (i.e. India, Pakistan, Bangladesh) as a major economic force by the year 2040. Demography alone supports this conclusion, as do existing assets and resources of the countries involved. **Acknowledging this emerging reality, the European**

Union and its Central Asian partners should combine forces to advance the opening of the most direct and efficient transit corridors between Central Asia and the Indian subcontinent. In this process, multiple corridors will be essential as a means of assuring openness and driving down costs through competition. These southern routes should be understood as an essential but separate supplement to the Silk Road Corridor, and their creation the task of the transit countries themselves, along with the EU and its members and international financial institutions.

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