

THE EU AND KAZAKHSTAN: DEVELOPING A PARTNERSHIP IN TRADE AND TRANSPORT

S. Frederick Starr & Svante E. Cornell

In 2015, the EU revised its Strategy for Central Asia, and finalized an Enhanced Partnership and Cooperation Agreement with Kazakhstan. These welcome steps will not turn the EU into a regional powerhouse overnight, but provide the EU with a platform to play a constructive role in Central Asia. The EU can achieve that if it avoids focusing on issues where it has little hope of direct influence, such as regional security affairs and domestic governance. Instead, to gain such a role eventually, the EU should focus on revitalizing the promise of its visionary initiative of the 1990s – the Transport Corridor linking Europe to Asia via the Caucasus and Central Asia – which it allowed to slip, handing the initiative to other powers, primarily China.

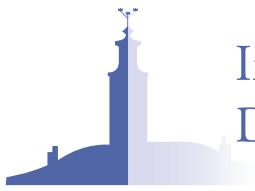
On December 21 in Astana, the EU and Kazakhstan signed an Enhanced Partnership and Cooperation Agreement. This agreement, the first of its kind with a Central Asian country, had been initialed in January 2015, and provides an important platform for European engagement with Central Asia. In June, the EU Council in June 2015 also adopted the so-called Council Conclusions on the EU Strategy for Central Asia, effectively updating the document dating to 2007. The signing of the Enhanced PCA took place on the sidelines of the eleventh EU-Central Asia Ministerial Meeting, which gathered representatives of the five states of post-Soviet Central Asia, and at which EU High Representative Federica Mogherini termed developments in Central Asia “extremely important” to the European Union. Yet the PCA, and the broader Strategy, remain general documents that largely lack concrete priorities. They emphasize human rights as well as security and stability, yet the EU is unlikely to develop a sizable role in either area anytime soon. Security and stability in the region remains dependent largely on the regional states themselves, not least of them Afghanistan, and on the priorities of and interaction between Russia, China and the United States in the region. The EU can, and does, play a supporting role in enhancing border control and drug enforcement in the region, but has neither the intention nor the ability to expand its role to other areas. And whereas a number of EU member states have voiced strong concerns over the human rights situation in Central Asian

states, the EU lacks the influence to affect the situation. Europe is simply not important enough a partner to affect the domestic priorities of Central Asian leaders, and certainly not to mitigate the adverse effects of the informal power struggles within regional elites that are often at the heart of the lack of meaningful reform.

The EU’s Comparative Advantage: Trade and Transport

There is, however, an area in which the EU could have significant impact – and one that would, in the long run, make it a much more credible force in enhancing security and promoting human rights. That is the development of Continental Transport and Trade – an area where the EU took the initiative in the early 1990s but ran out of steam.

With its visionary but poorly implemented TRACECA project (Transport Corridor Europe-Caucasus-Asia), the EU pioneered the idea of rebuilding trade and transportation arteries between Europe and Asia across Central Asia and the Caucasus. 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 gained currency in a virtual competition of initiatives. The U.S. launched its New Silk Road (NSR) initiative in 2010, which nevertheless remained focused on a North-South axis centered on Afghanistan, and failed to get the endorsement from the Presidential level needed for its success. In 2013, China



launched the much more well-endowed Silk Road Economic Belt. It is remarkable that the EU is now absent from the list of leaders of this grand project. In fact, initiatives of the regional countries themselves have gained a profile much greater than TRACECA's. Kazakhstan and Uzbekistan have made major investments in railroad development; Azerbaijan, Kazakhstan and Turkmenistan have each developed modern port facilities on the Caspian Sea; and Azerbaijan, Georgia and Turkey are about to complete the missing links in a railroad corridor that could link Hamburg to Hanoi. Further west, Georgia has developed the capacity of its Black Sea ports, while Lithuania has pioneered a "Viking Railway" linking the Baltic and Black Seas across Belarus and Ukraine.

But while overland trade links offer great potential benefits, these corridors are only in a formative stage. Approximately 90 percent of the cargo from Europe to China is transported by ship via the Suez Canal; most of the remaining volume is flown by air. 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 a need 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. It is in these areas that the EU could play an important role.

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, as the signing of the Enhanced PCA shows, Kazakhstan is the Central Asian country that has gone the farthest in terms of deepening institutional cooperation with the EU. 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 in a year, from 53rd 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.

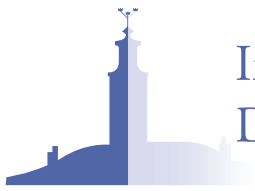
To date, the EU and Kazakhstan have focused their efforts almost entirely on the link between China and Europe. In light of the advanced development of infrastructure along this route, such a focus is entirely natural. However, Europe's long-term interest will include an equal emphasis on connecting Europe and India. This development is almost inevitable, given the demographic future of the Indian sub-continent (India, Bangladesh, and Pakistan). Within twenty years this region will be far more populous than China and, unlike China, with its rapidly ageing population, all three countries on the Indian sub-continent will have a far larger working-age population. In this respect, India's cohort alone will far outstrip China. Even if the economies of the subcontinent progress at a slower rate than China did in the period 1991-2016, one can be certain that the importance of their land trade with Europe will soar.

Kazakhstan's location offers great potential for such trade with both northern Europe and Russia, but such potential will not be achieved without focused and joint attention to the Europe-Kazakhstan-India route by the EU and Kazakhstan together.

Promoting Market-Oriented Initiatives and "Soft Infrastructure"

So far, the efforts to promote Eurasian trade routes have been dominated by governmental programs, as is understandable with infrastructure. However, 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. Therefore, the building of trade links in Europe and Central Asia should focus not just on the completion of TRACECA, 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.

It is unfortunate that enthusiasm for the construction of “hard infrastructure” has relegated all other forms of infrastructure to a secondary status. 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. 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 Kazakhstan 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.

A second dimension 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, in which European and Kazakh experts could take the lead, should seek to identify the impediments that will inhibit the free development of private initiatives in each of these areas, and which 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.

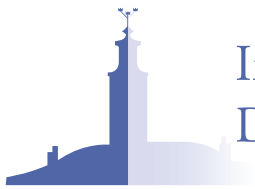
Further, effective measures must be taken to ensure that a key node is created along the China-Europe route for firms in all the key areas of soft infrastructure, e.g. freight forwarding, logistics, insurance, storage, supplies and equipment maintenance, and hotels. A glance at the map, as well as the country’s economic situation, shows that Kazakhstan is ideally situated to serve as a hub for these services.

However, geography is not destiny, and any number of impediments could neutralize the potential benefits Kazakhstan should derive from its location. While Kazakhstan has embarked on laudable efforts to diversify its economy and has a more beneficial business climate 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.

Serious and well-known impediments in Afghanistan and Pakistan/India have caused policy-makers to ignore the opening of a Europe-India route via Kazakhstan. This is a mistake. Both Europe and Kazakhstan have a serious long-term interest in this second continental corridor, and they should therefore be working together now to remove these impediments. Recent visits by the presidents of Pakistan and India to Central Asian capitals, the signs of a practical detente between India and Pakistan on the issue of trade, and the start of work on the TAPI pipeline, which involves India, Pakistan, and Afghanistan in a collaborative effort, justify cautious optimism. The EU and Kazakhstan should therefore place diplomatic work on behalf of a future EU-India corridor via Kazakhstan at the top of their regional diplomatic agendas, and begin making practical plans for such a land corridor in the event that a breakthrough occurs.

Going Forward: EU-Kazakhstan Cooperation on a Logistics Hub

The EU and Kazakhstan, involving official bodies but especially the private sector, should develop a partnership 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 the EU-Kazakhstan partnership 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 (AIFC), 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. To establish Astana as a financial center, the AIFC will essentially operate under its own legal regime, derogated from national law. 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.

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, the EU should begin the process at once on a bilateral basis through its Enhanced PCA with Kazakhstan. However, a bilateral approach can only be a precursor and never a substitute for the region-wide arrangements that both the EU and Central Asian countries need.

S. Frederick Starr is Chairman and Svante E. Cornell Director of the Central Asia-Caucasus Institute & Silk Road Studies Program, a Joint Center affiliated with Johns Hopkins University-SAIS and the Institute for Security and Development Policy.

The opinions expressed in this Policy Brief are those of the authors and do not necessarily reflect the views of the Institute for Security and Development Policy or its sponsors.

© The Institute for Security and Development Policy, 2015. This Policy Brief can be freely reproduced provided that ISDP is informed.

ABOUT ISDP

The Institute for Security and Development Policy is a Stockholm-based independent and non-profit research and policy institute. The Institute is dedicated to expanding understanding of international affairs, particularly the interrelationship between the issue areas of conflict, security and development. The Institute's primary areas of geographic focus are Asia and Europe's neighborhood.

WEBSITE: WWW.ISDP.EU