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**Central Asia:
Landbridge between East Asia and the EU, or stuck in the middle?**

Richard Pomfret

Professor of Economics, University of Adelaide, Adelaide SA 5005, Australia
and
Adjunct Professor, The Johns Hopkins University Bologna Center, Italy

richard.pomfret@adelaide.edu.au

ABSTRACT: In the context of current tensions between the EU and Russia over Ukraine, this paper asks where Central Asia's future will be in the global economy. Although Russia is seeking to cement ties within a customs union, economic links to Russia have been declining over the 22 years since the dissolution of the Soviet Union. Today the EU is Central Asia's largest economic partner, and since 2000 China the fastest growing. These relations are soundly based on specialization by comparative advantage, and if trade costs continue to fall the East-West link between Central Asia and China and the EU will flourish. On the other hand, if politics triumph and Central Asian governments chose an exclusionary regional arrangement with Russia, then they risk being sidelined from the global economy in any role other than as primary product exporters dependent on volatile world prices.

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Central Asia: Landbridge between East Asia and the EU, or stuck in the middle?

Media headlines in late 2013 featured demonstrations in Ukraine driven by competition between Russia and the EU for influence in the former Soviet Union. President Putin clearly believes that the December 1991 dissolution of the USSR was a disaster needing to be reversed. His principal vehicle for attaining this political goal is the customs union established in 2010 with Belarus and Kazakhstan. The Baltic countries are members of the EU, and the current competition centers on the EU's would-be Eastern Partners – Moldova, Ukraine and the Caucasus. The Central Asian situation is unclear; it is farthest from the EU, but Russian hegemony is not assured. Kazakhstan is in the customs union, with the Kyrgyz Republic and Tajikistan being pressed to follow, but since becoming independent Uzbekistan and Turkmenistan have made determined efforts to avoid being drawn into Russia's sphere of influence.

This paper focuses on economic aspects of the competition for influence. In the two decades since independence, the five Central Asian countries have signed many bilateral and regional agreements, none of which had much effect before the 2010 customs union. The five countries pursued *de facto* multilateral trade, selling their primary product exports at world prices and importing from least-cost preferred-quality suppliers. In terms of their trade flows this was reflected in the dramatic decline in Russia's share and emergence of the EU as a major trade partner in the 1990s, and the rapid growth of trade with China since 2000 (Table 1).

Table 1: Ten Major Export and Import Markets, billion US dollars, 2000 and 2010.

Exports			Imports		
	2000	2010		2000	2010
EU	3.7 (23.8)	31.9 (37.7)	Russia	3.1 (27.2)	17.2 (27.3)
Russia	3.6 (23.3)	13.8 (16.4)	EU	2.2 (19.0)	11.1 (17.5)
China	0.7 (4.8)	12.4 (14.6)	China	0.3 (2.4)	6.8 (10.7)
Iran	0.5 (3.3)	4.0 (4.8)	USA	0.6 (5.1)	4.1 (6.6)
Turkey	0.4 (2.5)	2.7 (3.1)	Turkey	0.5 (4.6)	2.5 (4.0)
Switzerland	0.6 (4.1)	1.7 (2.0)	S. Korea	0.4 (3.8)	2.2 (3.5)
USA	0.2 (1.5)	1.1 (1.3)	Pakistan	0.2 (1.3)	1.9 (3.1)
Japan	0.1 (0.5)	0.6 (0.7)	Iran	0.2 (2.0)	1.8 (2.8)
S. Korea	0.1 (0.9)	0.4 (0.4)	Japan	0.3 (3.0)	0.9 (1.4)
India	0.1 (0.4)	0.3 (0.3)	India	0.1 (0.9)	0.8 (1.3)

Source: Mogilevskii (2012a, 30-1), based on data from COMTRADE and national statistical offices.

Notes: totals include Afghanistan as well as the five Central Asian countries; numbers in parentheses are percentage shares.

What are the implications for the future? Media reports focus on the political struggle between the EU and Russia, but both contestants are hamstrung by their limited range of instruments. Underlying economic forces, especially trade by comparative advantage, favor east-west trade rather than north-south trade, and ongoing and planned infrastructure projects will further strengthen this orientation. Central Asia's role will be as a transit route between China and the EU, with the possibility of joining global value chains for economies that reduce trade costs and improve the ease of doing business.

1. Central Asia between East and West

Overland trade across the Eurasian landmass has a long tradition dating back at least to the “silk routes” connecting China and India to western Asia and Europe in the second century BCE. Urban centers like Samarkand and Bukhara flourished at the start of the second millennium. Central Asia’s long period of economic decline was driven by improved ocean travel between Europe and South and East Asia, and the impoverished region was incorporated into the Russian Empire in the second half of the nineteenth century. Economic ties were increasingly directed north towards Russia. After the 1960 Sino-Soviet split, physical connections between Central Asia and China were broken. Only at the very end of the Soviet era were road connections reopened and the first rail link between Kazakhstan and China constructed.

In the Soviet era the five Central Asian republics were part of an integrated economy in which republic borders had little if any economic significance. Dissolution of the Soviet Union in December 1991 ushered in a period of regional disintegration as the new independent countries issued national currencies, established national trade policies and border controls, and focused on creating national transport networks. In general, their focus was on nation-building rather than foreign affairs. The five Central Asian countries all joined the United Nations, IMF and World Bank in 1992, but were suspicious of committing to organizations that might impinge on their newly acquired sovereignty.

The Soviet successor organization, the Commonwealth of Independent States, proved ineffective. Some Soviet successor states sought to distance themselves from Russia, notably the Baltics whose goal was EU membership and the GUAM grouping of Georgia, Ukraine, Azerbaijan and Moldova, while Turkmenistan obtained a UN declaration of its neutrality. Others formed a Russian-led Eurasian Economic Community (EurAsEc). Uzbekistan allied itself with the USA in the 1990s, briefly flirted with GUAM, joined EurAsEc in 2005 and exited EurAsEc *de facto* in 2008. The many attempts to form a specifically Central Asian organization all failed. The five Islamic republics in Central Asia, together with Azerbaijan and Afghanistan, joined Iran, Pakistan and Turkey in the Economic Cooperation Organization (ECO). The new independent states remained suspicious of China, but economic links were revived, primarily by the activities of unofficial small-scale traders, in addition to trade on the Kazakhstan-China rail link. The process of border delimitation involved political confidence-building and creation of an institutional framework which evolved at the end of the 1990s into the Shanghai Cooperation Organization (SCO). By 2005 the three regional agreements in which the Central Asian countries were members were headquartered in Moscow (EurAsEc), Beijing (SCO) and Tehran (ECO).

The multilateral institutions continued to point out the foregone benefits that integration could bring, and created frameworks for cooperation. The United Nations commissions for Europe (UN-ECE) and for Asia and the Pacific (UN-ESCAP) set up a Special Programme for Central Asia (SPECA). A consortium of multilateral institutions led by the Asian Development Bank (plus EBRD, Islamic Development Bank, IMF, UNDP and World Bank) created Central Asian Regional Economic Cooperation (CAREC). The impact of all of this activity was minimal.¹ Perhaps the most important

¹ Pomfret (2009) and Laruelle and Peyrouse (2012) provide taxonomies and analysis of the various regional agreements involving the Central Asian countries. The SCO is active, but largely in non-economic areas. CAREC and SPECA involve regional cooperation coordinated

output was the recognition by CAREC of the joint importance of hard and soft infrastructure, combining of the transport and trade facilitation committees, and establishment of a sophisticated monitoring system that highlighted the time and money costs of trade within Central Asia (CAREC, 2012).

Despite all of the regional agreements, the Central Asian countries effectively pursued multilateralism, selling their raw materials on the world market and seeking out least-cost sources of imports. By 1997 Russia's share of their trade had fallen below half. In 1998 the Kyrgyz Republic became the first former Soviet Republic to join the WTO, but applications by other Central Asian countries languished, and neutral Turkmenistan has not even applied (Table 2).

Table 2: WTO Status, Central Asian Countries and Neighbors

	Date of Application	Date of Accession
Kazakhstan	1996	--
Kyrgyz Republic	1996	1998
Tajikistan	2001	2013
Turkmenistan	No	--
Uzbekistan	1994	--
China	1986	2001
India	Charter member	Charter member
Iran	1996	--
Russia	1993	2012
Ukraine	1993	2008

Source: WTO website at www.wto.org/

UNDP (2005) and ADB (2006) highlighted the benefits from cooperation, but trade issues went off the agenda in the years after 2005. They returned in 2010 with establishment of a customs union between Kazakhstan, Russia and Belarus, followed by Russia in 2012 and Tajikistan in 2013 joining the WTO. The customs union stimulated other initiatives to revive integration (Linn, 2012), such as the US Silk Road Initiative in 2011, the US-articulated post-2014 plans for Afghanistan and the EU's revived interest in Eastern Partnerships.

2. Russia looks South

The most significant regional integration move since 1991 is Kazakhstan's customs union with Russia and Belarus. The agreement was signed in November 2009, and a common external tariff and customs code established in 2010. In July 2011 customs controls at the members' common borders were abolished. The common external tariff was weighted towards the Russian tariff. Russia was able to keep 82% of its customs tariffs unchanged and lowered 14% and increased 4% of its tariffs; the corresponding shares for Kazakhstan were 45%, 10% and 45% (Libman and Vinokurov, 2012, 49).

The welfare effect of a customs union is theoretically ambiguous. However, in the case of the EurAsEc customs union, initial expectations were of negative welfare implications for Kazakhstan. Raising the external tariff while allowing duty-free

by multilateral institutions. A network of intra-CIS bilateral trade agreements exists, although it is difficult to assess implementation (Idrisov and Taganov, 2013, Table 1).

imports from Russia was a recipe for trade destruction and trade diversion, and a simple but plausible model by IMF economist Patrizia Tumbarello (2005) estimated substantial welfare loss for Kazakhstan. Moreover, the negative impact is likely to be exacerbated by administrative changes and increased non-tariff barriers, e.g. newly designed sanitary and phytosanitary (SPS) rules make it harder for the Kyrgyz Republic to export its farm products to Kazakhstan (Djamankulov, 2011) and tighter controls on the customs union's external borders will discourage informal, or currently poorly monitored, imports into Kazakhstan from the Kyrgyz Republic and China (Mogilevskii, 2012b).²

Why did Kazakhstan take this step when *ex ante* studies suggested that the customs union would yield negative returns to Kazakhstan? Libman and Vinokurov (2012) emphasize the reassertion of Russian economic strength as an important long-run attraction of a Russian-centered grouping, and the financial crisis of 2008 as a short-term stimulus for a defensive partnership. Laruelle and Peyrouse (2012, 44-5) see the empirical literature as indicating potential short-run benefits for Kazakhstan, but a long-term negative impact as foreign investment, technology and knowledge transfer flows decline. Mogilevskii (2012c, 33) highlights the immediate increase in tariff revenue, by at least USD1.4 billion in 2011. The EBRD study (Isakova et al., 2013) is more agnostic – small negative short-term effects on Kazakhstan, but uncertain long-term effects – perhaps suggesting that forming the customs union was a political, rather than economic, decision.³

The negative effects will be reduced as Russia implements its WTO accession commitments, effectively lowering the customs union's common external tariff and liberalizing Russia's domestic market. When Russia joined the WTO in 2012 its commitments included substantial tariff reductions (to an average tariff of 8% by 2020), elimination of some non-tariff barriers to trade, and written clarification of other non-tariff measures that affect trade.⁴ All of these policies will be implemented *de facto* as changes in the customs union's common external commercial policy. With the 2020 external trade policies, the customs union is likely to be less harmful to Kazakhstan than what has been suggested by estimates made before Russia's WTO accession. If the net outcome is of market integration with lower transactions costs and external tariffs that

² Silitski (2010) argues that the main reason for Russia promoting the customs union was to control imports from the EU and China, which were evading tariffs, taxes and other restrictions by routing via Belarus and Kazakhstan respectively. Laruelle and Peyrouse (2012, 44) highlight the drastic effect of the customs union on the Kyrgyz Republic's role as a platform for re-exporting Chinese goods and claim that the number of Kyrgyz wholesale traders fell by 70-80% in 2010-11. CAREC (2012, 38-9) reports that while average border-crossing time for trucks leaving Kazakhstan for Russia fell from 7.7 hours in 2011 to 2.9 hours in 2012, the average border-crossing time for trucks entering Kazakhstan from outside the customs union increased from 8.6 to 21.5 hours, with "waiting in queue" the biggest part.

³ Earlier studies such as Isakova and Plekhanov (2012), Mogilevskii (2012c) and World Bank (2012) had too little data to draw convincing empirical conclusions. Mogilevskii (2012c, 22) emphasizes the number of contemporary exogenous shocks that obscure identification of pure customs union effects.

⁴ WTO accession commitments go beyond tariffs and NTBs. The *Final Report* on Russia's accession contains 758 pages, excluding the specific commitments on goods and services, which are in annexes, and it includes, *inter alia*, rules for the treatment of foreign investors, constraints on trade-distorting (amber box) agriculture subsidies, and rules on intellectual property, public procurement and foreign trade regime transparency. Shepotylo and Tarr (2012) calculated that in 2020 after the transition period Russia's weighted average bound tariff will be 8.2% and the applied tariff 7.6%.

do not discriminate greatly against non-members, then the net welfare effect could be positive. The desirability of this type of “open regionalism” has been championed by Vinokurov (2013).

Nevertheless, the long-term net benefits remain uncertain. Economic theory is clear that a customs union is a second-best arrangement, which may or may not improve over the preceding tariff-ridden situation, but which is inferior to non-discriminatory trade liberalization. The argument that a customs union is necessary for a small economy to achieve economies of scale is false, because with open trade policies the world is the market. The scale economy argument is belied by the success of the relatively small first generation new industrializing economies (Hong Kong, Singapore, Taiwan and South Korea), and the dismal performance of the most populous countries as long as they sheltered their producers from global competition (rapid growth in China, India and Brazil dates from major opening up of their economies in 1978/9, 1991 and 1995 respectively). There may be dynamic gains from market integration. The empirical evidence shows that customs unions and free trade areas have been harmful when they have erected a wall around a protected market, but sometimes beneficial when they have low external protection and focus on integrating the internal market by trade-facilitating measures (Pomfret, 2001).

In January 2012 the creation of a Common Economic Space (CES) began. The aims of the CES include creation of a common market in goods, services, labour and capital; coordination of monetary, financial and tax policies; development of unified transport, energy and information systems; and unification of systems of state support for innovation and priority sectoral development. In July 2012 the Eurasian Economic Commission (EEC), a supranational executive body comprising deputy prime ministers, was established. The CES is a further step beyond a customs union and the consequences of creating an integrated economic space are more far-reaching and at this stage difficult to evaluate.

How far will creation of a common economic space go? Widening and deepening are on the horizon. The Kyrgyz Republic and Tajikistan, both already members of EurAsEc, are the most likely new members of the CES, and a steering committee for integrating the Kyrgyz Republic into the customs union already meets (a road map was approved at the EEC’s October 2013 summit, although reconciling Kyrgyz WTO commitments with the external tariff of the customs union is a major obstacle),⁵ with the sixth EurAsEc member, Armenia, a more distant prospect, and Moldova and Ukraine even more distant, and more challenging, future members. These potential new members are all in the WTO. If Kazakhstan finalizes its own WTO accession, this could reinforce steps towards an open rather than an exclusionary regionalism. The beyond-trade aspects of the CES could be especially valuable for the poorer Central Asian countries; both the Kyrgyz Republic and Tajikistan would benefit from regularization of the status of migrant workers and resolution of issues such as those workers’ pension rights.⁶ However, restriction so n those countries’ economic links with non-members, notably China, could have seriously negative welfare effects.

⁵ According to *WTO Trade Policy Review* (2013, 25), 30% of Kyrgyz duties align with those of the customs union, 21% can be realigned without violating WTO commitments, and 49% would require renegotiation of WTO terms (and potentially compensation to affected WTO members) before they could be aligned.

⁶ The current CES Agreements on labor migration reduce the number of documents required by migrant workers, increase the timeframe for registration and permissible period of uninterrupted stay, grant social rights to the migrant’s family (especially in education), and provide guarantees about information availability to migrants. EDB (2013a) concludes that a key accession issue

Beyond debates about the economic impact, the customs union is clearly part of a geopolitical struggle in which Russia is trying to re-establish hegemony over at least part of the old Soviet Union. The challenges to this vision are China's burgeoning economic influence in Central Asia, which has firm foundations and will be difficult (but not impossible) to limit by policy instruments, and the EU's attempts to bring the western CIS countries into its own sphere of special trade relations. For Kazakhstan, and future CES members, the scenarios are either a welfare-reducing closed regionalism or a more open regionalism, in which market forces will drive economic relations and Russia's economic significance will continue to decline.

3. The EU looks East

The EU's relations with the countries of Eastern Europe and the Soviet Union were dramatically transformed by the collapse of Communism between the June 1989 Polish elections and the dissolution of the USSR in December 1991. For most Eastern European countries, including the three Baltic countries, the consequence has been EU membership, either achieved or aspired to. The EU has since 1992 been undecided whether to treat the twelve non-Baltic Soviet successor states as a group or individually or in sub-groups, and whether to focus on comprehensive agreements or functional arrangements (e.g. on transport, border management, and drugs). Additionally, widely divergent national interests among EU members, especially in the area of oil and gas, have led to bilateral relationships at national level sometimes dominating EU relations.⁷

Equal treatment is made difficult by the huge disparities in size between Russia (a G8 member), Ukraine and the others, as well as by differing physical proximity to the EU (Ukraine borders four EU member countries). Current EU policy distinguishes between Russia, six "Eastern Partnership countries" from the western former Soviet Union and the Caucasus, and the five Central Asian countries, although within the last two groups *de facto* treatment is not uniform. The instruments at the EU's disposal have broadened since the early 1970s when the EU established a "pyramid of preferences" based on preferential tariffs, but the EU still faces the challenge of pursuing foreign policy goals, with nuanced hierarchical relationships and limited, primarily economic, instruments.

The dramatic collapse of Communism in Eastern Europe in the second half of 1989 posed immediate challenges for the EU. With German reunification, East Germany became part of the EU in 1990, transforming the EU from a Union with 4-5 fairly equal-sized large members to one in which the demographic and economic weight of Germany became pronounced. The next challenge was assimilation of three countries that had been unwilling to join the EU as long as they were on the front line of the Cold War, although accession of Austria, Finland and Sweden in 1995 was relatively simple because they had similar economic and political systems to the 12 existing members. A much greater challenge was posed by the membership applications of Central and

for the Kyrgyz Republic is to ensure that these conditions apply to new entrants creating something similar to Schengenland. EDB (2013b) argues that the origin countries also need to adopt policies that reduce the demand for emigration.

⁷ This paper focuses on EU-level relations. While recognizing that individual EU members' may have differing interests that they pursue individually, a paper cannot cover all 27 members. The monitoring group EUCAM, which posts working papers and policy briefs on EU relations with Central Asia (at <http://www.eucentralasia.eu>) runs a National Series of policy briefs with reports on individual EU members' relations with and policies towards Central Asia.

Eastern European countries in transition from central planning, all of which aspired to membership. Their accession, apart from the remaining Yugoslav successor states and Albania, was concluded in 2004 and 2007.⁸

Amidst all of this turmoil, the EU paid less attention to the twelve Commonwealth of Independent States (CIS) countries, apart from Russia, which was too large to be ignored.⁹ The major regional initiatives were TACIS (Technical Assistance to the Commonwealth of Independent States) and the Transport Corridor Europe-Caucasus-Central Asia (TRACECA) program. TACIS was launched in 1991 to provide grant-financed technical assistance to the twelve newly independent non-Baltic Soviet successor states.¹⁰ TRACECA was set up in 1993 to develop an efficient and integrated transit transport system between Europe, the Caucasus and Central Asia.¹¹ Under TRACECA the EU has implemented sixty technical assistance and investment projects to the amount of over 121 million euros, covering issues such as training freight forwarders, contract supervision for highway rehabilitation, agreements on transport of dangerous goods, and maritime and civil aviation training.¹² Since 2007 EU assistance is determined within the framework of EU Neighbourhood Initiatives and cooperation in the field of development and economic intercommunication (DCECI).

The Eastern Partnership (EaP) was launched by the EU member states and six partner countries at a May 2009 summit in Prague. The EaP offers deeper integration with the EU structures by encouraging and supporting partners in their political, institutional and economic reforms based on EU standards, as well as facilitating trade and increasing mobility between the EU and the partner states. Association Agreements were implemented with Ukraine in 2007, and with Armenian, Azerbaijan and Moldova in 2010, and creation of deep and comprehensive free trade areas (DCFTAs) between the EU and the partner states is envisaged.¹³ Visa facilitation and readmission

⁸ Croatia joined the EU in 2013. Iceland, Macedonia, Montenegro, Serbia and Turkey are candidate countries, and Montenegro and Kosovo potential candidates. However, further expansion is unlikely for some time

⁹ I use CIS as a short-hand for the twelve non-Baltic former Soviet republics, although the CIS has been a largely ineffective organization, and at various times Georgia and Turkmenistan have been *de jure* or *de facto* non-participants.

¹⁰ Mongolia was also included in the TACIS program for part of the period.

¹¹ The Multilateral Agreement on International Transport for Development of the Europe-Caucasus-Asia Corridor was signed in Baku on 8 September 1998 by twelve countries, including four of the Central Asian countries and the office of the Permanent Secretariat was opened in Baku in 2001. Turkmenistan was subsequently included in TRACECA.

¹² In addition TRACECA projects have identified areas for funding by multilateral institutions, e.g. the EBRD loaned \$65 million to Kazakhstan and \$40 million to Uzbekistan for railway rehabilitation after TRACECA projects had identified weaknesses in the region's rail system, and TRACECA has co-financed projects, e.g. providing the border crossing component of the ADB's loans for upgrading the Bishkek-Almaty road. The European Commission allocated 13.5 million euros under TRACECA Action Programme 2006.

¹³ The Association Agreements, which replaced the Partnership and co-operation Agreements which the partner states (except for Belarus) concluded with the EU in the late 1990s, contain three parts: a) political dialogue and foreign and security policy; b) justice, freedom and security; c) economic and sectoral co-operation. They provide a framework for co-operation on a wide range of issues, and are also aimed at bringing the partner countries closer to EU standards of governance. The DCFTAs involve not only the liberalization of trade in all areas, by lifting customs barriers and trade quotas, but also harmonization of partner countries' trade-related legislation with EU standards and the *acquis communautaire*. Because membership of

agreements have been signed with Ukraine, Moldova and Georgia, and lifting the EU visa requirement for citizens of partner states is a key long-term objective; a ‘visa dialogue’ is envisaged, and has begun with Ukraine and with Moldova, to determine the conditions each country needs to fulfill in order to have the Schengen visa requirement lifted. The scope of participation in the EaP and the level of integration with EU structures will vary from country to country, depending on internal situations and aspirations, and the EaP neither promises nor precludes the prospect of EU membership. Table 3 summarizes the current stages of negotiations between each partner and the EU.

Table 3: Status of EU Eastern Partnership negotiations

	negotiations on Association Agreements	negotiations on DCFTA	visa facilitation and readmission agreements	visa dialogue
Armenia	started in July 2010	--	technical dialogue is under way, but negotiations have not started yet	--
Azerbaijan	started in July 2010	does not meet the precondition for starting the negotiations, which is WTO membership	--	--
Belarus	--	does not meet the precondition for starting the negotiations, which is WTO membership	--	--
Georgia	started in July 2010	--	came into force in March 2011	--
Moldova	started in January 2010	should begin in 2011	came into force in 2008	started in June 2010
Ukraine	started in March 2007	started in February 2008	came into force in 2008	started in October 2008

Source: <http://www.easternpartnership.org/content/eap-s-bilateral-dimension> (accessed 2 December 2013)

EU involvement in the five Central Asian countries has been limited. The larger EU countries established a diplomatic presence, sometimes coordinated in a shared building, but always low priority and low profile. European Commission funds were provided in the 1990s under the TRACECA and TACIS programs, neither of which had a major impact.¹⁴ During the 1990s, when oil prices were low and production facilities

the World Trade Organization is a precondition, Azerbaijan and Belarus, which are not WTO members, cannot yet start DCFTA negotiations. Georgia and Moldova initialed their DCFTAs at the November 2013 EaP summit in Vilnius, but Ukraine pulled out and Armenia did not sign due to incompatibility with considering accession to the EurAsEc customs union.

¹⁴ Some useful research projects, especially in agriculture and in rural development, were carried out under the TACIS umbrella. The INOGATE (Interstate Oil and Gas Transport to Europe) program, aimed at promoting the regional integration of pipeline systems and facilitating the

often antiquated, the EU showed little interest in Central Asian energy resources. A larger concern was the narcotics trade, and since the turn of the century the best-funded initiative of the European Commission has been the BOMCA/CADAP program.

The BOMCA/CADAP program has been a more concerted European Commission initiative in Central Asia. This was initially driven by the drug component, CADAP (the Central Asian Drug Action Programme), intended to intercept narcotics being transported from Afghanistan through Central Asia to Western Europe. The accompanying rise in domestic drug abuse in Central Asia had already led to measures by Central Asian governments which were harmful to legal trade; the general response to drug trafficking was to tighten border controls, which led to economic hardship for border communities and small traders, pushing some of those people into the drug trade.¹⁵ The principal focus of the EU's Border Management in Central Asia (BOMCA) Programme has been on upgrading border crossing points and providing sniffer dogs, training for customs officials, and equipment. As part of revising the EU Central Asia Strategy, the BOMCA program was reviewed in 2006-7, and the consequence was a shift from border control to risk assessment and compliance facilitation. BOMCA signaled the importance of behind-the-border trade costs in trade facilitation by embracing the corridor concept, although BOMCA's strength in delivery continued to be at border crossing points.

In addition to EU-funded projects individual EU member countries have provided development assistance to countries. For individual Central Asian countries, the leading bilateral donors include Germany, France, Sweden, Poland and the United Kingdom. Other bilateral donors involved in Central Asia include the USA, Turkey, Japan, Switzerland, South Korea, Russia and China.

The EU's net economic and political impact in Central Asia has been small. Some individual EU companies have had a high profile in individual countries (e.g. see Garcia (2006) on Bouygues in Turkmenistan) or in energy projects, but overall they have lagged behind the higher profile of Russian or US companies and the increasing Chinese economic presence. In parts of the region Turkish, Iranian or South Korean economic presence outweighs that of the EU.

Political relations deteriorated as the ill-starred 2003 EBRD annual meetings in Tashkent highlighted the lack of political leverage that European countries had in authoritarian Central Asian states. The Andijon incident in May 2005 led to a more serious rupture between Uzbekistan and EU members, including the imposition of sanctions by the EU. More narrowly the shooting of citizens by Uzbek security forces perhaps armed with equipment provided under the BOMCA program raised questions about the nature of EU involvement.

Under the German presidency in the first half of 2007, the EU proposed a new strategy for Central Asia.¹⁶ The initiative, which had stalled under the Portuguese

transport of oil and gas both within the greater Eastern Europe and CIS region and towards the export markets of Europe, was also funded under the TACIS Regional Co-operation Programme. Despite grand objectives, none of these EU schemes made a big impact in Central Asia.

¹⁵ All Central Asian governments except Turkmenistan made opium cultivation illegal and took steps to combat drug trafficking. In practice, however, many government officials up to high levels were implicated in the drugs trade and interdiction was selective.

¹⁶ Personalities may matter. Frank-Walter Steinmeier, Foreign Minister in the German Grand Coalition 2005-9 is a Russophile who was keen to improve relations between the EU and the former Soviet space, while his successor Guido Westerwelle took Russo-German relations to a

presidency, was picked up by the French presidency in the second half of 2008. The Joint Declaration of the EU-Central Asia Forum on Security Issues in Paris on 18 September 2008 defined the main policy areas for joint action as:

- combating illicit trafficking in arms, sensitive material, narcotics and human beings
- combating terrorism and extremism
- cooperation in energy and the environment

However, the area of energy cooperation has been either negligible or divisive so far. Individual companies' involvement in specific projects has triggered *ad hoc* political actions, but this not been part of a consistent EU or national policy; for example, Eni's lead role in Kazakhstan's Kashagan offshore oil field led Italian Prime Minister Romano Prodi to travel at short notice to Astana in October 2007 and his successor Silvio Berlusconi made a brief unannounced weekend trip to Astana in October 2008.

The main political division within the EU has concerned pipelines for oil and natural gas. At first sight EU buyers and Central Asian suppliers would appear to have common interest in developing alternative pipeline route. However, the huge cost involved make projects mutually exclusive and EU countries reliant on Russian gas supplies, such as Germany and Italy, have been unwilling to antagonize Russia by open support for pipelines that bypass Russia and hence compete with Russia's pipeline network.

4. China looks West

The major change in Central Asian economic relations in the twenty-first century has been the rapid rise in importance of China as a trading partner and financer of infrastructure projects. There are obvious complementarities between Chinese manufactured exports and Central Asian comparative advantage in primary products that China imports. China's growing economic presence was highlighted by President Xi Jinping's high-profile September 2013 tour when he visited four Central Asian countries before attending the SCO summit in Bishkek; President Xi met all five Central Asian presidents, and pledged over \$50 billion in Chinese funding for energy and infrastructure projects.¹⁷

In the 1990s, apart from minerals entering China by rail from Kazakhstan, much of China's trade with Central Asia was unmonitored and small-scale, conducted by so-called shuttle traders. As Central Asian governments tightened their borders or monitored bazaars more closely, transactions costs increased and the shuttle trade became less attractive by the end of the decade. A second cause (but also a consequence) of the decline of shuttle-trading was the Kyrgyz Republic's emergence as

new low in 2013 by supporting the Ukrainian protesters and announcing a boycott of the Sochi Winter Olympics.

¹⁷ India hopes to play a part in the region, but its 2012 "Connect Central Asia Policy" was effectively trumped by President Xi. When ConocoPhillips announced in November 2012 that it wanted to sell its 8.33% share in Kazakhstan's Kashagan mega-oilfield, India's ONGC Videsh Ltd thought that it was the preferred buyer, but in July 2013 Kazmunaigas invoked its first-buyer right to preemptively purchase the share and then sell it to the China National Petroleum Corporation (CNPC). India's long-standing hope for a TAPI (Turkmenistan-Afghanistan-Pakistan-India) pipeline to bring Turkmen gas to South Asia also appeared to be sidelined by Xi's proposal for a Turkmenistan-Afghanistan-Tajikistan-China pipeline (Boulègue, 2013; Tanchum, 2013).

an entrepôt, importing goods from China and elsewhere, to be sold in huge bazaars outside Bishkek and Osh to customers from all across Central Asia. Although much of the trade is unrecorded, major customers appear to be from Uzbekistan.¹⁸ In 2008 the Dordoi bazaar in Bishkek employed 55,000 people, had 40,300 sales outlets and annual sales of \$2,842 million, of which \$2,131 million are estimated to have been foreign sales (to ultimate customers in Uzbekistan, Kazakhstan and Russia); facilities included overnight accommodation and well-organized local and long-distance transport facilities. The smaller Karasuu bazaar in Osh (annual sales in 2008 of \$684 million, of which \$400-500 million went to Uzbekistan) involved mainly ethnic Uzbek traders with family connections on both sides of the border; being more closely integrated into Uzbekistan's economy, it is more vulnerable to border crackdowns by the Uzbekistani authorities.¹⁹ In sum China's exports to Central Asia blossomed between 2000 and 2010 (Table 1), although precise magnitudes are unknown.

The other major component of China's economic relations with Central Asia has been imports of minerals, oil and gas, and other primary products. For the energy-rich Central Asian countries exploiting and exporting were major issues in the 1990s, when pipelines ran north through Russia and the *Transneft* monopoly. A small gas pipeline was opened between Turkmenistan and Iran in 1997, and a private pipeline from Kazakhstan to the Black Sea in 2001. After 2005 Kazakhstan was able to ship oil across the Caspian to the Baku-Ceyhan pipeline to the Mediterranean. However, the main game changers were the oil pipeline completed in stages between 2003 and 2009 from the western Kazakhstan oilfields to China, and the gas pipeline from Turkmenistan to China completed in 2009.

The gas pipeline was the strongest demonstration of China's interest and potential role in Central Asia. Turkmenistan's President Niyazov (aka Turkmenbashi the Great), who was notoriously unwilling to travel, visited Beijing in March 2006, where he reached agreement on a gas pipeline. Russia tried to pre-empt the project by offering to build a pipeline along the Caspian coast from Turkmenistan to Russia. The EU encouraged Turkmenistan to commit to exporting its gas through Turkey to hook up to the Nabucco pipeline through southeastern Europe. In just over three years China had built the pipeline and gas was ready to flow. Moreover, Turkmenistan, Uzbekistan and Kazakhstan agreed on the pipeline route, on transit rates, and on options for Kazakhstan and Uzbekistan to export their own gas through the pipeline; given the previous record of non-cooperation among Central Asian countries, this was a notable achievement by China. Eight years later the Russian pre-Caspian project and the EU Nabucco project are still on the drawing board.²⁰

China has also been active in the poorer countries, Tajikistan and the Kyrgyz Republic, partly as an investor but also providing aid in the form of road-building and so

¹⁸ In 2001 the Kyrgyz Republic and China were the only countries in the neighborhood that were WTO members, and Kyrgyz trade barriers were low. The Kyrgyz Republic does not closely monitor imports from China, e.g. in 2008 China reported exports to the Kyrgyz Republic of \$9,213 million, while the Kyrgyz statistics indicated imports of \$728 million from China (Mogilevsky, 2009, Table 5). A World Bank (2009) analysis of 2008 mirror statistics found that the Kyrgyz Republic had "excessive" imports and Uzbekistan "under-imports".

¹⁹ Data are from surveys in summer 2008 (World Bank, 2009). On the operation of the bazaars, see also Kaminski and Raballand (2009) and Kaminski and Mitra (2010).

²⁰ With uncertainty about future gas prices following technological advances and the option of importing LNG from Qatar, Australia and other countries with ocean access, it is unlikely that further overland pipelines will be built in the foreseeable future.

forth. In contrast to Russian and EU interaction with Central Asia, most of China's activities have been low key – at least until President Xi's September 2013 visit. Pipelines and other investments are presented as business arrangements. Politically China presents itself as a good neighbor, with similar concerns to Central Asian governments, especially with respect to extremism and splittism.²¹

5. Conclusions and Prospects for the Future

Central Asia's self-perception has often been voiced as a cross-roads between Europe and Asia or as the core of Eurasia. This is reflected in membership of two UN regional bodies (ECE and ESCAP), hosting of both European and Asian regional meetings, and participation in European and Asian sporting events. In economic terms, however, the cross-roads function has been dormant for over five hundred years. From the 1860s until the 1990s, economic relations were overwhelmingly northwards to Russia. Only since the turn of the century have east-west relations begun to flourish

Both Russia and the EU appear to be viewing their Central Asian relationships in a competitive light, most recently borne out by the events in Ukraine in November and December 2013. If the EU's Eastern Partnership and the Russian-led EurAsEc customs union are constructed as exclusive arrangements, then this augurs badly for both. Such "fortress" arrangements are increasingly out-of-tune with a global economy in which the leading economies participate in global value chains requiring access to both inputs and markets under competitive conditions.

Both Russia and the EU are also hamstrung by limited policy instruments. Russia has influence over the Kyrgyz Republic and Tajikistan, both of which have heavy debt burdens and are dependent on remittances from large numbers of migrant labor working in Russia.²² Blocking market access or offering cheap energy may bring Ukraine to Russia's side, but these are not strong instruments given Russia's market size and prospects for future gas prices. The only effective security organization in the region is the Russian-led CSTO, and President Putin's position on human rights may be more congenial to Central Asian autocrats than the EU (or US) position. The EU can offer access to a much larger market, although it has little to offer beyond what WTO members receive as a right. The high-profile of EU multinationals, the prospects for visa-free travel and other benefits of being an EU partner have political traction, but its value is difficult to assess.

The US will continue to be viewed as a potential counterweight to Russia and China, especially by countries suspicious of Russian designs on the region.²³ From

²¹ China's main concern is separatism in Xinjiang Autonomous Region, where the Turkic-speaking Islamic Uighurs have strong cultural affinities with Kazakhs and Kyrgyz. The implicit agreement with Central Asian governments is that, as long as they do not support Uighur separatism, China has only peaceful intentions.

²² The remittances to GDP ratios, 48% in Tajikistan and 31% in the Kyrgyz Republic, are the highest and second-highest in the world; based on the World Bank's migration estimates for 2010 (at www.worldbank.org/migration).

²³ Uzbekistan fits this role, although relations with the US are threatened by its human rights record. Indeed, an irony of the region is that the most liberal economies (the Kyrgyz Republic and Kazakhstan). Symbolic of this divide was the early decision by Uzbekistan (and Turkmenistan) to adopt a Latin/Turkic alphabet, while Kazakhstan, the Kyrgyz Republic and Tajikistan have retained the Cyrillic alphabet.

an economic perspective, however, the US role after the 2014 withdrawal from Afghanistan is likely to be minimal with individual US companies participating in mining and energy activities or being competitive suppliers of agricultural and other equipment, but too far away to feature in regional value chains.²⁴

Central Asia is increasingly seen as a place with dynamic neighbors (three of the four BRICs), rather than as a disadvantaged landlocked region.²⁵ Trade and investment links with China have grown rapidly. Changes in the global economy, notably the emergence of more complex global and regional value chains, point to advantages of being in a good neighborhood. China often plays a central role in global value chains (so-called “Factory Asia”), and for such networks to flourish trade costs, in both money and time, must be low.

China’s manufactured exports are mainly produced in the eastern coastal provinces, but in recent years the government has pursued a “look west” policy and regions such as Sichuan Province and Chongqing Municipality are thriving. One consequence has been establishment of regular rail service between Chongqing and Duisburg; after some false starts in 2010 and 2011, regular services were operating in 2013 (Böcking, 2013; Bradsher, 2013), and routes from Chengdu and Zhengzhou to Europe are also being established (Summers, 2013). This Eurasian Landbridge rail link offers an attractive price/time option, faster than by sea and at lower cost than by air, to electronics firms in western China (e.g. HP, Acer and Foxconn) supplying EU markets and to EU firms shipping parts to their operations in China (e.g. Volkswagen, Audi and BMW).²⁶ There are plans to construct a high-speed rail line that could cut China-EU travel time to two days.

Whether Central Asia will merely be a transit route, or whether the improved communications could provide a springboard for economic diversification within Central Asia is a critical question. The main obstacle to Central Asian participation in global value chains is the high cost of doing business, and in particular of doing business across international borders, as reflected in low rankings on indicators such as the World Bank’s *Doing Business* measures, and poor logistics infrastructure.²⁷ Unsurprisingly, the few examples of new activities adding value to competitively obtained inputs are in

²⁴ Similar comments apply to other second-rank players in the region such as Japan, South Korea Australia, or ASEAN countries

²⁵ The problems of landlockedness in Central Asia have been analysed by Raballand (2003), Grafe, Raiser and Sakatsume (2005), Cadot, Carrère and Grigoriou (2006) and Grigoriou (2007). Linn (2004) was one of the first to point out the potential benefits of Central Asia’s location.

²⁶ Chinese proposals for a high-speed rail service that would link Shanghai to Berlin in two days via Astana are not implausible given the speed with which China constructed its domestic high-speed rail network. The high-speed line to Urumqi, the capital of Xinjiang, where a large new rail terminus is being constructed, is scheduled for 2014 completion.

²⁷ In the World Bank’s *Doing Business 2014* rankings <http://www.doingbusiness.org/rankings> the Central Asian countries rank among the very worst in the “Trading across Borders” category: Kyrgyz Republic 182nd., Kazakhstan 186th., Tajikistan 188th., and Uzbekistan 189th., out of 189 countries (Turkmenistan was not ranked). In the overall ranking they all ranked substantially higher: Kazakhstan 50th., Kyrgyz Republic 68th., Tajikistan 143rd., and Uzbekistan 146th. Such survey data must be taken with a pinch of salt, but is supported by the CAREC time/cost monitoring which was based on 3,124 trips in 2012 and found that, for example, crossing the Uzbekistan-Kazakhstan border at Karakalpakya took on average 30 hours at the Kazakhstani border post and 14 hours at the Uzbek post while at the border crossing between China and Kazakhstan the average time at the Chinese border was 353 hours and at the Kazakhstani border 54 hours (CAREC, 2012, 21-4).

the Kyrgyz Republic, which is a WTO member with the most market-friendly economy in the region.²⁸

²⁸ The Kyrgyz textiles and clothing industry collapsed after 1991, but re-emerged in the 2000s with clothing exports to Russia and Kazakhstan of better quality items than were coming from western China and beating eastern China producers on price. The clothing producers are mostly small and informal; official estimates are of exports of \$170 million in 2008 falling to \$155 million during the global recession in 2009, and of employment just over 100,000, but the actual numbers for exports and employment are believed to be three to four times higher. Material inputs are mostly imported (Birkman et al., 2012).

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